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No. 12946

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

AMERICAN CRYSTAL SUGAR COMPANY, a corporation,

Appellant,

vs.

MANDEVILLE ISLAND FARMS, INC., a corporation, ROSCOE C. ZUCKERMAN and G. K. EVANS,

Appellees.

APPELLANT'S OPENING BRIEF.

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Appellees.

APPELLANT'S OPENING BRIEF.

This appeal is taken from those portions of a judgment of the District Court for the Southern District of California awarding treble damages, attorney's fees and costs under Section 4 of the Clayton Act, 15 U. S. C., Section 15, to the plaintiffs in two consolidated actions. Appellees Mandeville Island Farms, Inc., and Roscoe C. Zuckerman were the plaintiffs in Action No. 4643-BH below [R. 3], and G. K. Evans was the plaintiff in Action No. 8353-BH [R. 154]. The order consolidating the two actions was made at the commencement of the trial. [R. 305.]

Jurisdiction.

As indicated above, the jurisdiction of the District Court was primarily invoked under Section 4 of the Clayton Act. [Mandeville-Zuckerman complaint and amended complaint, R. 3, 54; Evans Complaint, R. 154; Finding 1, R. 251.] Diversity of citizenship and jurisdictional amounts under 28 U. S. C., Section 1332, were also appropriately alleged. [R. 3, 54, 154; Findings 2(a), 2(b), 2(c), 4, R. 251-252.]

The jurisdiction of this Court is invoked under 28 U. S. C., Section 1291, the appeal being taken from specified portions of a final judgment and decision of the District Court. [R. 277-278.]

The statutes hereinabove mentioned are believed to sustain the respective jurisdictions of this Court and of the District Court, and they constitute the basis upon which appellant contends the District Court had jurisdiction below, and this Court has jurisdiction to review the judgment appealed from.

Statement of the Case.

1. *Basic Facts.* This controversy centers around a change in the method utilized by defendant and appellant, a beet sugar manufacturer, in determining the price to be paid to growers for sugar beets grown under contract with appellant in an area which supplied sugar beets for appellant's Clarksburg, California, factory. Both prior and subsequent to the crop years[1] of 1939, 1940 and 1941

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[1]A crop year or season comprises a period of twelve months, commencing on August 1 of the calendar year whose number it bears. References to given years hereinafter found in this brief will be understood to refer to crop years.

appellant's growers were paid on the basis of a contract formula comprising two variable price determination factors: (1) the percentage sugar content of the beets grown by the particular grower, and (2) the average net return[2] received from sugar (a) manufactured at appellant's Clarksburg, California factory, and (b) sold during the crop year in question [Finding 8, R. 258; Ex. A, R. 76]; in other words, what may be termed a *single net* method, measured by net returns from sugar from appellant's own factory.

During what we may term the critical years of 1939, 1940 and 1941, however, the second variable of the formula was changed to the average net return received from sugar (a) manufactured at the factories of the three sugar companies operating in Northern California (*i. e.*, appellant and its two competitors in that area), and (b) sold during the crop year in question [Findings 9(b), 9(e), R. 260, 261; Exs. B, C and D, R. 83, 90, 96]; in other words, what may be termed a *joint net* method, measured by the averaged net returns from sugar from, not appellant's factory alone, but of the factories of each of the three companies operating in the Northern California area. Appellees each grew and sold beets to appellant during specified years of this three-year period.

The Court found that this joint net method was the result of a combination and conspiracy on the part of

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[2]The factors going to make up the net return are (1) the gross receipts from sugar sold during a given crop year, less (2) deducted expenses, which comprised federal excise tax, freight on sugar to destination and sales and marketing expense items, all as detailed for the years 1938 through 1942 in the tabulated exhibit reproduced in the appendix hereto.

appellant and its two competitors, that it eliminated competition between the three manufacturers in the purchase of sugar beets, that it deprived the beet growers of a reasonable price for their beets, that it illegally fixed the price of sugar beets, that it intentionally hindered and obstructed the free and natural flow in the purchase of sugar beets and that an illegal monopoly had been established during the three critical years[3] in which it was in operation. [Findings 9, 11, 12, 13, 19, R. 259, 262, 267.]

2. *Interstate Commerce.* It will have been noted that the restraints found all relate to the sugar *beets,* which the District Court in turn found [R. 256] "were planted, grown, harvested and processed into sugar *wholly within the State of California,*" and not to the *sugar* manufactured from the beets. As to the *sugar,* the Court found that it "was, during all of such period, sold in interstate commerce throughout the United States." [R. 255.]

This situation is of interest because the District Court, for reasons which will be discussed later herein, not only failed to find, but steadfastly refused to find, that the activities complained of had any effect whatever on interstate commerce, or any effect whatever upon the price, supply or competitive conditions with reference to *sugar,* the only interstate commodity involved in the case. Indeed, the District Court made it amply evident that if a finding on this subject had been made, it would have been that the activities complained of did *not* affect interstate commerce. [R. 810, 811.]

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[3]As indicated above, the single net method came back into use in 1942. [Finding 13, R. 262.]

The question is therefore presented as to whether or not, absent a finding as to any effect upon interstate commerce, the findings support the judgment of violation of the anti-trust laws; or, to use the terminology of Rule 52, Federal Rules of Civil Procedure, whether or not the judgment of violation directed to be entered was an *appropriate* judgment in the absence of a finding that the activities complained of had a substantial economic effect upon interstate commerce. This question will be discussed in the body of the brief.

3. *Past History of the Litigation.* This litigation has had an interesting and curious history. This is the second time the Mandeville-Zuckerman case has been before this Court. (159 F. 2d 71, sub. nom. *Mandeville Island Farms, Inc. and Roscoe C. Zuckerman v. American Crystal Sugar Company,* No. 11266, affirming judgment on motion to dismiss granted by the District Court, 64 Fed. Supp. 265.) The history of the *Mandeville* case in its early stages in the District Court and through this Court was accurately portrayed in the dissenting opinion of Mr. Justice Jackson (Mr. Justice Frankfurter concurring) when the case reached the Supreme Court. (*Mandeville Island Farms, Inc. and Roscoe C. Zuckerman v. American Crystal Sugar Company,* 334 U. S. 219.)

Mr. Justice Jackson there said:

> "It appears to me that the Court's opinion is based on assumptions of fact which the petitioner disclaimed in the Court below. These assumptions are permissible inferences from the amended complaint only if we disregard the way in which the amendments came about.

"On hearing, the trial judge apparently considered that a cause of action would be stated only if the complaint alleged that the growing contracts affected the price of sugar in interstate commerce. *But the contracts accompanying the pleadings indicated that the effects ran in the other direction. The market price of interstate sugar was the base on which the price of beets was to be figured. The latter price was derived from the income which respondent and others received from sugar sold in the open market over the period of a year.*[4] The trial judge therefore suggested that the references to restraint of trade in sugar in interstate commerce created an ambiguity in the complaint. Accordingly, the plaintiff, at the suggestion of the court and for the specific purpose of this appeal, filed an amended complaint which completely eliminated the charge that the agreements complained of affected the price of sugar in interstate commerce, and eliminated the two other counts 'to enable the Court herein to pass upon the sufficiency of the first count on its merits and, further, to make possible a speedy and inexpensive review by appeal if the Court held that the first count was insufficient.' The District Court then held that since no beets whatever moved in interstate commerce and since there was no charge in the amended complaint that the cost or quality of the product which did move in interstate commerce was in any way affected, no cause of action was stated. The appeal was taken and the Circuit Court of Appeals affirmed." (334 U. S. 246-249; footnote omitted.)

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[4]Emphasis here, as elsewhere, is supplied unless otherwise noted.

The foregoing appraisal of the situation is amply borne out by the record herein. [R. 314-316; and see R. 285-303.]

We thus perceive that the District Court granted appellant's original motion to dismiss on the theory that a price-fixing of beets alone was charged as distinguished from a charge of restraint as to sugar, the interstate product. This Court affirmed on the same theory. The Supreme Court, however, adopted appellees' argument that since sugar *was* the only interstate product, the allegation in Paragraph IX of the amended complaint [R. 61] as to a conspiracy "to unlawfully monopolize and restrain trade and commerce among the several states and to unlawfully fix prices to be paid the growers of sugar beets"[5] did charge a restraint as to the *sugar* (334 U. S. at pp. 244-246), despite the accuracy of Mr. Justice Jackson's appraisal of the true situation.

The materiality of this past history lies in the fact that the Supreme Court did not pass upon the complaint from the standpoint of a pleading charging, without more, a restraint as to a farm product which never crossed state lines. Still less did it pass upon the situation revealed by the undisputed *evidence* in this case, adduced after the reversal and remand, which was to the effect that the stabilization of the price of sugar beets had no effect whatever upon the price, supply or competitive conditions as to *sugar* [R. 694, 720]; evidence which appellees did not even attempt to refute.

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[5]Originally characterized by appellees as a monopoly and restraint of trade and commerce in *sugar and sugar beets* among the several states and to unlawfully fix the price of sugar beets. [Complaint, Par. XI, R. 11.]

4. *The District Court's Interpretation of the Supreme Court's Decision and its Refusal to Find as to the Issue of Effect Upon Interstate Commerce.* Following the reversal and remand of the case, the District Court adopted the view that the decision of the Supreme Court rendered on the *pleadings,* constituted the law of the case as to the fact, *without necessity of proof,* of liability under the anti-trust laws; and that therefore nothing remained for it to do but to fix the damages. [See, for instance, Memorandum Opinion at R. 226; Conclusion of Law 3, R. 270; remarks of court at R. 804.]

Entertaining the view that this factual question had been decided for it in advance, the District Court steadfastly refused to make *any* finding as to the effect of the activities complained of upon interstate commerce. At the same time, it candidly made it clear that if it *had* made a finding upon the subject, it would have found that the combination with reference to the ~~best~~ BEET prices *had no effect* upon interstate commerce.

This latter fact is evidenced by the court's own remarks [R. 810, 811] and by the fact that it eliminated every finding on the subject which was proposed in earlier drafts of the findings save one, which apparently crept into the final draft by iadvertence; and that one finding was then stricken by the court on motion of appellant. [R. 274-276.]

5. *Damages.* The District Court, as damages for the years 1939 and 1940 (Mandeville), awarded the difference, trebled, between the price per ton of beets actually paid

under the joint net method for those years, and the average of the prices per ton paid to growers in the crop years 1937 and 1938 for beets of the same sugar content under the single net method. For 1941 (Zuckerman and Evans), the award was a flat 25¢ per ton of beets delivered, trebled. It was and is the contention of appellant that the proper measure, had liability been established, would have been the trebled difference between what the respective appellees actually had been paid under the joint net method for 1939 and 1940, as to Mandeville, and for 1941, as to Zuckerman and Evans, and what they respectively would have received had the single net method been used for those years, the figures as to which were stipulated to and made available to the court. It was and is further contended by appellant that since the amounts which they would have received under the single net method for the very years in question were proven to the penny, any recourse to the figures of other years, or any utilization of a flat figure per ton was unnecessary, excessive and prejudicial. Under the findings it is perfectly obvious that all that the appellees were deprived of were the advantages of the efficiency of the processor with which they dealt as reflected in its higher single net *when it was higher* (than the computed joint net). It necessarily follows that the proper measure could only have been the difference as to each year, between what the appellees respectively received under the joint net and what they would have received under the single net; all as is hereinafter discussed.

Specification of Errors.

With all respect, the District Court erred in the following particulars:

1. In rendering judgment for appellees and against appellant.

2. In holding and deciding that the decision of the Supreme Court on the prior appeal in *Mandeville Island Farms, Inc., et al. v. American Crystal Sugar Company,* 334 U. S. 219, relieved appellees of the necessity of proving (as distinguished from alleging) that the activities complained of had a substantial economic effect upon interstate commerce.

3. In failing to find as to the issue of whether or not the activities complained of had a substantial economic effect upon interstate commerce.

4. In failing to find that the activities complained of had no effect upon interstate commerce.

5. In awarding damages in the amounts specified in the judgment.

6. In its application of the measure of damages.

7. In failing to hold that the proper measure of damages was the excess, if any, trebled, and as to each of the three years involved, of the amounts which appellees severally would have received under the single net method of price determination, over what they actually received when paid under the joint net method; and

8. In failing to apply such proper measure.

SUMMARY OF ARGUMENT.

I.

The District Court Erred in Rendering Judgment for Appellees and Against Appellant.

A. The District Court erred in holding and deciding that the decision of the Supreme Court on the prior appeal in *Mandeville Island Farms, Inc. v. American Crystal Sugar Company* (334 U. S. 219) relieved appellees of the necessity of proving (as distinguished from alleging) that the activities complained of had a substantial economic effect upon interstate commerce.

1. The holding on the prior appeal was that the Mandeville amended complaint stated a cause of action under the Sherman Act; it in no way dispensed with the necessity of proving such cause of action.

B. The conclusions of law and judgment against appellant are not supported by the findings.

1. In order to warrant a recovery in a treble damage suit under the Sherman Act, a plaintiff must plead and prove, and the trial court must find, that the activities complained of as having caused him damage, had a substantial economic effect upon interstate commerce.

2. The District Court here declined to make any finding whatever as to the issue of effect upon interstate commerce; and it repeatedly eliminated or deleted findings proposed by appellees as to that issue.

3. If the District Court had found that the activities complained of had a substantial economic effect on interstate commerce, such findings would have been clearly erroneous as being contrary to the undisputed evidence.

(a) The undisputed evidence was that the activities complained of had no effect whatever upon the price, supply or competitive conditions with reference to sugar, the only interstate product involved in the case.

II.

The District Court Erred in Awarding Damages in the Amounts Specified in the Judgment.

A. The District Court erred in its application of the measure of damages.

1. The correct measure of damages is the difference (trebled) between the amounts actually realized by appellees, during the three crop years involved, from the sale of their beets to appellant, and what would have been realized by them during such period in the absence of the combination complained of.

2. Translated to the facts of these cases, and assuming, for purposes of discussion only, that injury from a Sherman Act violation was both proved and found, the proper measure is the excess, if any, trebled, and as to each of the three years involved, of the amounts which appellees would severally have received had they been paid for their beets upon the basis of appellant's own (single) net return from sugar sold from its Clarksburg factory, over the amounts which they severally did receive when paid upon the basis of the joint net returns from sugar sold from appellant's Clarksburg factory and from the factories operated by the two other sugar companies in northern California.

(a) These are not cases where appellant's acts have prevented appellees from making precise proof of their damages; the amount of such damages, ascertained by the measure properly applicable to these cases, was proven to the penny.

B. The damages actually awarded were speculative and inconsistent.

ARGUMENT.

I.

The District Court Erred in Rendering Judgment for Appellees and Against Appellant.

A. The District Court Erred in Holding and Deciding That the Decision of the Supreme Court on the Prior Appeal in Mandeville Island Farms, Inc. v. American Crystal Sugar Company (334 U. S. 219) Relieved Appellees of the Necessity of Proving (as distinguished From Alleging) That the Activities Complained of Had a Substantial Economic Effect Upon Interstate Commerce.

1. THE HOLDING ON THE PRIOR APPEAL WAS THAT THE MANDEVILLE AMENDED COMPLAINT STATED A CAUSE OF ACTION UNDER THE SHERMAN ACT; IT IN NO WAY DISPENSED WITH THE NECESSITY OF PROVING SUCH CAUSE OF ACTION.

What the Supreme Court did was, in effect, to overrule a demurrer. Reversing a granted motion to dismiss amounts to nothing else. In such a case, that Court, precisely as the District Court had done, was compelled to take the *then* undenied allegations of the complaint as true. That it did so on the prior appeal is amply evident from the majority opinion itself, bearing in mind that it also interpreted the complaint as charging a restraint as to the sugar recognized by Mr. Justice Rutledge as "the only interstate commodity." We quote:

> *"The material facts pleaded, which stand admitted as if they had been proved for the purposes of this proceeding may be summarized as follows:"* (334 U. S. at p. 222.)
>
> * * * * * * * *
>
> "Little more remains to be said concerning the amended complaint. *The allegations comprehend all that we have set forth."* (334 U. S. at p. 244.)

Clearly, the Court was dealing with facts *alleged,* and with nothing else.

After the Supreme Court's ruling, appellant answered, denying the material allegations of the complaints. The question now is, not what appellees had *alleged,* but what they have *proved* under the Supreme Court's holding, which in actuality was that the Mandeville complaint stated a cause of action. This simply meant that the burden still remained on appellees to prove their case at the trial as to all material allegations controverted by the pleadings. And not the least of these was the point blank denial that there had been any restraint of trade in interstate commerce, which is to say, as to *sugar.* [Compare amended complaint, Par. IX, R. 61, *et seq*; Par. XII, R. 64-65; Par. XIX, R. 71-72, with answer, Par. 5, R. 127 *et seq.*]

In other words, the rule here has full application that a determination by an appellate court that a complaint states a cause of action constitutes the law of the case[6] only to the extent that the allegations thereof, deemed to be true on the former appeal, are substantiated by *proof.* (*Aaron v. Hopkins* (5 Cir.), 63 F. 2d 804, 805; *Page v. Arkansas National Gas Corporation* (8 Cir.), 53 F. 2d 27, 31; *City of Sedalia v. Shell Petroleum Corporation* (8 Cir.) 81 F. 2d 193, 196; *Archer v. City of Los Angeles,* 19 Cal. 2d 19, 29; *Allen v. Calif. Mutual Bldg. & Loan Assoc.,* 22 Cal. 2d 474, 482; *Abroms v. N. Y. Life Ins. Co.,* 64 Cal. App. 2d 449, 456.)

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[6]We recognize, of course, that the doctrine of the law of the case here has strict application only to the *Mandeville-Zuckerman* causes of action. However, since the District Court treated the Supreme Court holding binding *in toto* [R. 270], the discussion is also apt as to the *Evans* case.

The case last cited accurately states the rule as follows:

> "However, in giving consideration to the decision on the prior appeal to determine the extent to which the law of the case therein announced is applicable in determining the instant controversy it must be borne in mind that the former appeal was from a judgment based upon an order sustaining a demurrer to the complaint without leave to amend. *In that proceeding, being upon demurrer, it was required that the truth of the allegations contained in the complaint be assumed.* Acting upon that assumption, this court held on the former appeal that the complaint stated a cause of action, ordered that the demurrer be overruled and that the proffered amended complaint be filed. *But, unless the evidence adduced at the trial proved the allegations of the complaint which was considered upon the former appeal, the doctrine of the law of the case does not apply.* In other words, if the trial court was justified, as we are persuaded it was, in holding that appellants' evidence failed to substantiate the allegations of the complaint and the amended complaint, then the decision of this court in passing upon the demurrer interposed to the original complaint *was not binding upon the trial court as the law of the case, nor is it binding upon this court on this appeal, in passing upon the sufficiency of the evidence to support the allegations of the pleadings* (*Allen v. California Mutual Building & Loan Association,* 22 Cal. (2d) 474, 481, 482 [139 P. 2d 321]; *Archer v. City of Los Angeles,* 19 Cal. 2d 19, 29 [119 P. 2d 1]." (64 Cal. App. 2d at p. 456.)

It was in this latter respect that the District Court erred in its interpretation of the scope and effect of the holding of the Supreme Court on the vital issue as to whether the activities complained of had the substantial economic effect upon interstate commerce which the Sherman Act condemns. The Supreme Court held that a restraint as to sugar was *alleged,* but after the case came down, the allegation was point blank *denied.* This cast the burden upon the appellees of proving interstate effects if they could, and it likewise cast the duty upon the court of making a finding, *one way or the other,* upon this issue, vital in any anti-trust case. And this it did not do, *although recognizing that appellees had failed to prove their case in this vital particular.*

B. The Conclusions of Law and Judgment Against Appellant Are Not Supported by the Findings.

1. In Order to Warrant a Recovery in a Treble Damage Suit Under the Sherman Act, a Plaintiff Must Plead and Prove, and the Trial Court Must Find, That the Activities Complained of as Having Caused Him Damage, Had a Substantial Economic Effect Upon Interstate Commerce.

This principle is fundamental. Nothing is better settled than that in order to make out a case under the Sherman Act, a showing must be made that the activities complained of had an economic effect (and the cases say a *substantial* economic effect) upon interstate commerce (*Apex Hosiery Co. v. Leader,* 310 U. S. 469, 500-501 and cases cited; *Wickard v. Filburn,* 317 U. S. 111, 121-125.)

This means that the question of effect upon interstate commerce goes to the very heart of the action. A plain-

tiff in a treble damage suit must therefore not only plead and prove, but the court must *find* the existence of a substantial economic effect on interstate commerce; otherwise the findings support neither the conclusions of law nor the judgment as regards a pronouncement of an anti-trust violation. In this regard the instant case differs in no respect whatever from the host of cases where the appellate court has remanded for failure of the trial court to find specially upon a material issue, as required by Rule 52a, Federal Rules of Civil Procedure. (See, for instance, *Marlborough Corp. v. U. S.* (9 Cir.), 172 F. 2d 787; *Paramount Pest Control Service v. Brewer* (9 Cir.), 170 F. 2d 553, following *Times-Mirror Co. v. National Labor Relations Board,* 331 U. S. 789; *Dearborn National Casualty Co. v. Consumers Petroleum Co.* (7 Cir.), 164 F. 2d 332; *National Savings & Trust Co. v. Shutack* (D. C. Cir.), 139 F. 2d 371; *Helfer v. Corona Products* (8 Cir.), 127 F. 2d 612.)

2. The District Court Here Declined to Make Any Finding Whatever as to the Issue of Effect Upon Interstate Commerce; and It Repeatedly Eliminated or Deleted Findings Proposed by Appellees as to That Issue.

As we have seen, the District Court here not only *failed* to find as to any interstate effect; it *refused* to do so and clearly indicated that but for its (with all respect, erroneous) interpretation of the scope and effect of the Supreme Court decision on the former appeal, it would have found that the activities complained of did *not* affect interstate commerce. The record in this regard is graphic:

> "The Court (on motion to amend findings): I felt that the conspiracy between the refineries had as its real objective the control of the growers and to pre-

vent them from dealing with the refineries that he may have wanted to deal with. In other words, that it more or less limited the grower to the place where he could sell beets and prevented any competition in that respect; *but I didn't feel that it had any effect upon the price of sugar in interstate commerce.* That is the reason I put everything in my conclusions of law . . ." [R. 810.]

* * * * * * * *

"The Court: I am not making a finding of fact. *If I had made a finding at all I would have made a finding that it did not affect interstate commerce,* but I wouldn't do that in view of the Supreme Court's decision." [R. 811.]

* * * * * * * *

"The Court: I wouldn't be surprised if the court sends this case back for a specific finding of fact on the sugar, but I have felt I should not do that in view of the Supreme Court's decision." [R. 812.]

The foregoing colloquy throws considerable light upon the trial court's views with reference to the case and serves to highlight the effect of its (and we say this with all respect) basic misconception of the effect of the Supreme Court's decision in the *Mandeville* case. It refused to find that there had been any effect upon sugar, the interstate product, because the evidence was all the other way; and Judge Ben Harrison, if we may respectfully be permitted to say so, is not the type of man to bolster up a judgment by making findings in which he does not believe. On

the other hand, the court felt that it was constrained by the Supreme Court decision from making a finding of no effect upon interstate commerce; a matter which we sincerely trust will be clarified by the opinion of this Court.

It is also worthy of note that this record now presents the case precisely as both the District Court and this Court believed it to have been presented on the first appeal: a restraint as to the sugar beets with no restraint (proved or found) as to the sugar; which was emphatically *not* the case treated by the Supreme Court, as Mr. Justice Jackson was so careful to point out.

We now turn to the proposition that if the District Court had (as it refused to do) found an interstate effect as regards the sugar, such finding would have been contrary to the undisputed evidence.

3. If the District Court Had Found That the Activities Complained of Had a Substantal Economic Effect on Interstate Commerce, Such Findings Would Have Been Clearly Erroneous as Being Contrary to the Undisputed Evidence.

(a) *The Undisputed Evidence Was That the Activities Complained of Had No Effect Whatever Upon the Price, Supply or Competitive Conditions With Reference to Sugar, the Only Interstate Product Involved in the Case.*

Since the District Court in any event made no finding as to any effect upon the sugar, it is not necessary to belabor the above points. Suffice it to say that the follow-

ing testimony in this regard of the two sales managers of appellant stands undisputed:

J. B. Hayden (Eastern Sales Manager).

"Q. (By Mr. Works): Mr. Hayden, will you please state whether or not the fact that during 1939, 1940 and 1941 these growers were being paid on a joint net basis had any effect whatever on either the price or the supply or competitive conditions with reference to sugar? A. No, Sir." [R. 694.]

* * * * * * * *

"The Court: That is the best kind of evidence you can have, counsel, that he didn't know it and there was no change in his methods." [R. 697.]

M. W. Hardy (Western Sales Manager).

"Q. From your experience is it or is it not the fact that this situation where the beet growers were paid on a joint net during 1939, 1940 and 1941 had no effect whatever on either price or supply or competitive conditions with reference to sugar? A. As a matter of fact I didn't know it was in effect.

Q. The joint net? A. No." [R. 719.]

It follows that, as the District Court observed in the remarks which we have quoted above, had a finding on this subject been made, it should have been a finding that the activities complained of did not affect interstate commerce, which should have been followed by conclusions of law and judgment to the effect that the case did not fall within the purview of the anti-trust laws.

II.

The District Court Erred in Awarding Damages in the Amounts Specified in the Judgment.

A. The District Court Erred in Its Application of the Measure of Damages.

As we have seen, the District Court measured the damages for 1939 and 1940 on the basis of the excess of what Mandeville would have received per ton of beets on the basis of the average of appellant's single net returns from sugar[7] sold during the 1937 and 1938 crop years, over what Mandeville actually did receive under the joint net method; while for 1941 it allowed Zuckerman and Evans a flat 25¢ per ton over what they had already received under the joint net method for that year. In doing this, with all respect, the Court erred.

In the first place, it is an *a fortiori* proposition that, since there was neither proof nor finding that the activities complained of had any effect upon interstate commerce, substantial or otherwise, it certainly cannot be said that appellees were injured in their business or property "by reason of anything forbidden by the anti-trust laws" within the meaning of 15 U. S. C., Section 15.

This follows for the reason that the courts have uniformly held that the plaintiff in a treble damage action

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[7]Bearing in mind as to both the single and joint net methods, that the net returns from sugar sales determined the beet prices, which were computed on a "reach-back" basis at the close of the year in which the beets were delivered and the sugar sold. As Mr. Justice Jackson was quick to observe, the sugar prices were the base for the beet prices and not the reverse. The stabilization of the beet prices thus had no effect upon the sugar prices, for "the effects ran in the other direction," as Mr. Justice Jackson put it.

must first show a violation of the anti-trust laws (a combination in restraint of trade or commerce *among the several states*) plus damage to the plaintiff *proximately* resulting from the acts of the defendant *which constitute a violation of such laws.* (*Glenn Coal Co. v. Dickinson Fuel Co.* (4 Cir.), 72 F. 2d 885; *Peterson v. Borden Co.* (7 Cir.), 50 F. 2d 644; *Jack v. Armour & Co.* (8 Cir.), 291 Fed. 741.) And such actions are founded, not upon the mere existence of a conspiracy, but upon injuries which result from the commission of *forbidden* overt acts by the conspirators. (*Suckow Borax Mines, Consol., Inc. v. Borax Consol.* (9 Cir.), 185 F. 2d 196, 208.)

In the second place, it also follows that since there was neither proof nor finding of a substantial economic effect upon interstate commerce, appellees have wholly failed to show the injury to the public interest which the Sherman Act condemns. We say this for the reason that it is fundamental that the main purpose of the Sherman Act was to protect the public from monopolies and restraints of trade with reference to commodities passing in interstate commerce, and that the individual right of action conferred by 15 U. S. C., Section 15, was but incidental and subordinate. (*Wilder Mfg. Co. v. Corn Products Co.*, 236 U. S. 165, 174; *Glenn Coal Co. v. Dickinson Fuel Co.* (4 Cir.), 72 F. 2d 885, 889; *Abouaf v. J. D. and A. B. Spreckels Co.* (N. D. Cal.), 26 Fed. Supp. 830, 833; compare *Lynch v. Magnavox Co.* (9 Cir.), 94 F. 2d 883, 891.)

The record is thus devoid of either proof or finding as to what the Supreme Court in the first Mandeville appeal (334 U. S. at 243) termed "the restraints put upon the public interest in the interstate sale of sugar," in conjunc-

tion with its holding (334 U. S. 244-246) that restraints as to the sugar were *alleged* and hence the amended complaint there under consideration stated a cause of action.

Since no interstate effects or effects adverse to the interstate public were either proven or found to have resulted from the activities here complained of, it follows that appellees, if injured at all, were not injured by any violation of the anti-trust laws under which they sued; and hence, upon the facts found, the District Court should have allowed them no damages whatever.

If we assume, however, that appellees did prove a substantial economic effect upon interstate commerce and resulting injury to the public interest by reason of the activities of the combination charged (which they did not) and that the Court, with substantial support in the evidence, so found (which it did not), the fact still remains that the correct measure of damages has not been applied to the facts of these consolidated cases.

1. The Measure of Damages Is the Difference Between the Amounts Actually Realized by Appellees, During the Three Crop Years Involved, From the Sale of Their Beets to Appellant, and What Would Have Been Realized by Them During Such Period in the Absence of the Combination Complained of.

The treble damage features of Section 4 of the Clayton Act envisage, first, an ascertainment by the Court of the actual damage suffered by the plaintiff from the act or acts causing him injury—no more and no less—plus a statutory trebling which is of course punitive in its nature.

The test is what would the plaintiff have received but for the acts of the combination shown to have injured him, less what, if any, he actually did receive during the period involved. Or, to put it in another way, the measure is the difference between the amounts actually realized and what would have been realized in the absence of the combination. This is the substance of the holdings in cases such as *Bigelow v. RKO Radio Pictures,* 327 U. S. 251, 262-3; *Story Parchment Co. v. Paterson Parchment Paper Co.,* 282 U. S. 555, 561-2; *City of Atlanta v. Chattanooga Foundry* (6 Cir.), 127 Fed. 23, 27; *Straus v. Victor Talking Machine Co.* (2 Cir.), 297 Fed. 791, 799 *et seq.* And see, also, *American Co-op Serum Assoc. v. Anchor Serum Co.* (7 Cir.), 153 F. 2d 907, 911 *et seq.*

The principal difficulty confronting a court in the ascertainment of damages in a Sherman Act case lies in finding a reasonable norm or standard by which to admeasure, in terms of money, the detriment suffered by the plaintiff during the effective period of the combination. The search for a reasonable standard is required because of the settled principle that, while the plaintiff is not held to proof of his damages with mathematical certainty, since a reasonable approximation based on *relevant* data is all that is required, nevertheless it is still the law that even in a case "where the defendant by his own wrong has prevented a more precise computation [*and these are not such cases*], the jury may not render a verdict based upon speculation or guess-work." (*Bigelow v. RKO Pictures,* 327 U. S. 251, 264.)

2. Translated to the Facts of This Case, and Assuming, for Purposes of Discussion Only, That Injury From a Sherman Act Violation Was Both Proved and Found, the Proper Measure Is the Excess, if Any, Trebled, and as to Each of the Three Years Involved, of the Amounts Which Appellees Would Severally Have Received Had They Been Paid for Their Beets Upon the Basis of Appellant's Own (Single) Net Return From Sugar Sold From Its Clarksburg Factory, Over the Amounts Which They Severally Did Receive When Paid Upon the Basis of the Joint Net Returns From Sugar Sold From Appellant's Clarksburg Factory and From the Factories Operated by the Two Other Sugar Companies in Northern California.

In searching for a reasonable norm or standard in these cases (assuming for the purposes of discussion only a proven and found violation of the anti-trust laws proximately causing them damage), it is first necessary to determine just how appellees were adversely affected by the combination of which they complain.

The very nature of the concerted action supplies the answer to this. The only effect of the combination so far as the appellees were concerned was to substitute, during the three years in question, a joint (three company) net method of settlement with the growers in lieu of the single (appellant only) net method which had customarily been in use in the Clarksburg area in prior years and which was restored in 1942. The result is, that during the three years in question, appellant's growers were deprived of the benefits of being paid for their beets on the

basis of the net sugar returns of Clarksburg alone. As the Supreme Court put it, the effect of the uniform agreement was to "deprive the grower of the advantage of the individual efficiency of the refiner with which he deals" and "of the price that refiner received." (334 U. S. at p. 242.) Or as the Court also put it in stating the facts:

> "Because beet prices were determined for the three seasons with reference to the combined returns of the three refiners, the prices received by petitioners for those seasons were lower than if respondent, the most efficient of the three, had based its prices on its separate returns." (334 U. S. at p. 224.)

Measured in terms of money, the advantage of appellant's individual efficiency would of course be reflected in its own net returns from sugar sold. Therefore, again measured in terms of money, the effect of the use of the joint net was, purely and simply, to deprive the growers of the advantage of being paid on the basis of appellant's higher single sugar net, as compared with the joint net, in the years when appellant's single net was in fact higher than the joint net, which was in 1940 and 1941.[8] This, then is *how* appellees were damaged as to the years in which they are respectively interested, which in the case of *Mandeville* was 1939 and 1940; and in the cases of *Zuckerman* and *Evans,* 1941.

The next question is how to measure this injury or damage in terms of money. And it is perfectly obvious

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[8]In 1939, Mandeville received slightly more from the joint net than it would have from appellant's single net. The joint net in that year was 3.131¢ per pound of sugar; appellant's single net (Clarksburg) was 3.123¢. [R. 343-344.]

that unless appellees have shown that the figures going to make up Clarksburg's single net returns from sugar for the years 1939, 1940 and 1941, were in some way tainted or rendered unreliable by the operations of the combination, we have not only a norm or standard (the Clarksburg *single* nets for those years applied to the sugar tables customarily in use before, during and after (1942) the period of the combination) but, what is more, *the appellees' damages not only may be, but have been proven with mathematical certainty.*

Appellees apparently recognized the necessity of showing some disqualifying effect upon the 1939, 1940 and 1941 Clarksburg (single) sugar net figures, for at the trial they claimed (but wholly failed to prove) that the expense item[9] of freight on sugar to destination had been adversely affected by the combination complained of. [R. 424.]

Despite this lack of proof on appellees' part, appellant proved without contradiction that any increase in freight

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[9]For the convenience of the Court, there is appended hereto a copy of the exhibit appearing at R. 222-223, filed pursuant to stipulation [R. 212-214] dated April 13, 1950, which exhibit [hereinafter referred to as "Exhibit of April 13, 1950"] tabulates for the years 1937 through 1942 all items going to make up the net returns from sugar sold and sets forth the single net of each of the three companies for each of those years and the joint net for the three years during which it was in use (1939, 1940 and 1941). The Holly and Spreckels figures were furnished by those companies at the joint request of the parties hereto.

costs during the three years in question was clearly due to natural competitive causes in the light of supply and demand and world conditions, such as a bumper beet crop in the Clarksburg area during 1939, 1940 and 1941, resulting in a surplus of sugar available for shipment East, with added freight costs, the outbreak of the war in Europe in 1939, with resultant presidential lifting of sugar sales restrictions, dislocation of cane sugar sources after Pearl Harbor, with resultant demand for beet sugar, added demand by canneries and military establishments, and the like. [R. 685-707, 717-20.]

Without further going into detail, the record shows precisely nothing which tends to impeach or disqualify the use of the Clarksburg *single* sugar net receipts figure, as compared with the amounts actually received by appellees under the joint net method, in arriving at the amount of appellees' (assumed) actual loss. In this way they would be compensated to the exact cent for any loss sustained from having been deprived of the individual efficiency of appellant and of the price which appellant actually received for its sugar during the three years in question.

The difference per pound of sugar between the joint net and appellant's single Clarksburg sugar net during those three years was as follows [R. 343-4]:

		Joint Net	Clarksburg Single Net	Difference
(Crop Year)	1939	3.131¢	3.123¢	—0.008¢
	1940	3.160¢	3.163¢	+0.003¢
	1941	3.950¢	3.970¢	+0.02¢

These figures when extended to cover the individual appellees' beet tonnage and sugar content (as per the sugar tables in use before, during and after the three years in question) would result in the following amounts, each being the exact sum of which the particular appellee was deprived through the use of the joint rather than the Clarksburg single net:

[Exhibit K for Identification. See Discussion at R. 725-726.]

(Crop Years)	(1) Clarksburg Single Net	(2) Tons Beets Delivered	(3) Percent Sugar in Beets	(4) Price Per Ton	(5) Total Amount	(6) Amount Paid	(7) Difference Between Columns (5) & (6)
1939 Mandeville	3.123¢	22,355.6	18.25%	$4.7749	$106,745.75	$107,262.18	$516.43 gain
1940 Mandeville	3.163¢	25,430.3	15.55%	$4.0502	$102,997.80	$102,767.13	$230.67
1941 Zuckerman	3.970¢	14,144.7	15.47%	$5,3576	$ 75,781.64	$ 74,794.76	$986.88
Evans	3.970¢	4,401.7	17.53%	$6.1924	$ 27,257.09	$ 27,080.00	$177.09

Mandeville 1940 ($230.67) trebled = $ 692.01
Zuckerman 1941 ($986.88) trebled = $2960.64
Evans 1941 ($177.09) trebled = $ 531.27

Instead of making its award on the above precise basis, the District Court, apparently on the theory that these were cases where, in the language of the decisions, "the defendant's unlawful acts prevented the plaintiffs from making more precise proof" of damages, applied, as we have seen, the averaged 1937 and 1938 Clarksburg nets to the 1939 and 1940 Mandeville tonnage, while for 1941 it awarded Zuckerman and Evans a flat 25¢ per ton. In this, with all respect, the District Court erred.

(a) *These Are Not Cases Where Appellant's Acts Have Prevented Appellees From Making Precise Proof of Their Damages; the Amount of Such Damages, Ascertained by the Measure Properly Applicable to These Cases, Was Proven to the Penny.*

This distinction is of the utmost importance in these cases. Precise proof certainly was not prevented on any theory, for here the exact single Clarksburg nets for the very years in question have not only been proven, *they have been stipulated to.* [R. 344.] And there can be no question but that settlement on the Clarksburg single net basis *for the years in question* was precisely what the utilization of the joint net method cost the appellees—no more and no less. It therefore follows that unless the appellees showed (as they wholly failed to show) that the Clarksburg single nets were in some way tainted by concerted action to which appellant was a party, their proof of actual detriment has been *exact and precise.* Certainly mere agreement to utilize a joint net basis of settlement would in no way operate to taint or to disqualify the company's *single* net, computed in the same way it had been computed both before and after the period during which the joint net was employed. Yet, that is *all* that appellees proved. Their basic claim, that the conspiracy had resulted in increased freight absorptions was not only supported by no proof whatever but was shown by appellant to be without the slightest foundation in fact.

There is a wide distinction between cases where, due to the activities of the combination, a plaintiff is *unable* to prove his loss save by reference to other years and cases where, as here, the plaintiff is fully able to apply the exact method of payment used either before or after the exist-

ence of the combination to his own actual operations during the period of combination activity.

Certainly in a price-fixing case the plaintiff is entitled to the difference between what he actually received and the reasonable price which the particular commodity would have brought in a free market; the price he would have received "but for" the alleged conspiracy. The cases all so hold.

The burden was on appellees in these cases to prove what that reasonable price was. This is not open to dispute. Bearing in mind the charge that what they had been deprived of was the single net settlement, we find them proving, by stipulated evidence, precisely what that single net return was for each of the three years during which the *joint* net method was used. *Prima facie,* the difference between the single and the joint net applications was of course their measure of damages. In justice and in fairness and as a matter of plain common sense it could be nothing else.

The single sugar net return was of course the derivative of two factors: (1), the *gross* receipts from the sale of Clarksburg sugar, less (2) deducted expenses, which comprised federal excise tax, freight on sugar to destination and sales and marketing expense (all as detailed on the exhibit of April 13, 1950).

In order to rebut the *prima facie* showing of damages which appellees themselves had made, it was of course necessary for them to impeach it if they could by showing that asserted concerted action participated in by appellant had operated to depress the single nets for 1939, 1940 and 1941.

How they attempted to do this was extremely significant.

They did not attack the individual gross receipts from Clarksburg sugar at all. They confined their ostensible attack to the *single expense item of freight on sugar to destination.* And they *proved* nothing as to that item. This is significant for two reasons: (1) it amounts to a direct confession that the activities of the combination did not affect the price structure of sugar in the least (which was wholly in accord with appellant's proof); and (2) it affords an unanswerable argument against the utilization, as a yardstick, of the single nets for years other than 1939, 1940 and 1941.

In sum, *eight* out of the nine factors going to make up the Clarksburg single nets for the three critical years stand wholly unchallenged. [R. 426-427.] And as we have seen, *appellees proved nothing in derogation of the validity of the ninth (freight) factor.* Such being the case, we submit that any recourse to the single nets for other years, such nets being made up from factors wholly different (only the federal excise tax item showing any degree of constancy) from those concededly correct for 1939, 1940 and 1941, was not only wildly speculative, but proved nothing in the face of the exact proof of each of the nine factors going to make up the single nets for 1939, 1940 and 1941.

Paradoxically enough, the District Court itself recognized that, due to appellant's own interest in the net returns, there could not be any rational inference that appellant was deliberately operating so as to reduce its own profits:

> "It would be pretty hard for me to infer that they were deliberately cutting down their own profits." [R. 700.]

In the light of the foregoing, it certainly may not be said that these are cases where the conduct of the appellant has precluded the appellees from precise proof of their damages. The plain fact is that appellees' damages, the difference between the return from the joint and single nets for the three years in question, have been proven with absolute certainty; and, assuming liability, the District Court should have so held.

Two cases dealing with the direct and certain proof of damages attributable to action found to be unlawful, are *Straus v. Victor Talking Machine Co.* (2 Cir.), 297 Fed. 791 (cited with approval in *Story Parchment Co. v. Paterson Co.,* 282 U. S. 555, 565), and *American Co-op Serum Assn. v. Anchor Serum Co.* (7 Cir.), 153 F. 2d 907.

In the *Victor* case, combined action on the part of Victor and its distributors resulted in depriving Macy's of its right to the regular distributor's discount of 40, 10 and 2% off for cash. As a result, Macy's was compelled to buy at straight retail prices. As to this, it was held that Macy's was entitled to the difference between what it actually paid and what it would have paid *during the monopoly period* "but for" the activities of the combination, being of course the amount of the discount.

The *American Co-op Serum Assn.* case was a treble damage suit brought for violation of 15 U. S. C. A., Section 13(a)(c)(d) and (f). The specific charge was price cutting contrary to a marketing agreement permitted by the Federal Serum and Virus Act of 1913. The effect of the price-cutting was to compel plaintiff to lower its prices of serum from 75¢ per c.c. to 65¢ to meet the cut prices, unlawful under the Act, of its competitors. It was held that plaintiff was entitled to the difference between the 65¢ and 75¢ per c.c. per sale during the period of the price

cutting; in other words, the price it would have received "but for" the unlawful action.

So here, the appellees proved that "but for" the concerted action, they would have received payment on the basis of the Clarksburg single net during the three years in question instead of the joint net settlement which they did receive. They proved nothing more. And the District Court erred in not so deciding.

B. The Damages Actually Awarded Were Speculative and Inconsistent.

The utilization of the 1937 and 1938 Clarksburg nets in ascertaining the 1939 and 1940 Mandeville damages were speculative because the exact Clarksburg nets for those years were available, stipulated to and not shown to have been tainted in any particular by the effects of the combination shown. The utilization of the flat 25¢ per ton figure for the Zuckerman and Evans 1941 crops were speculative for the same reason, since the 1941 Clarksburg net was also available, stipulated to and untainted; and for the further reason that the 25¢ per ton figure was wholly unrelated to any evidence in the case; a true situation of "picking a figure out of the air."

Its inconsistency is shown by the fact that had the District Court used the same criteria for 1941 as it did for 1939 and 1940, namely, the 1937 and 1938 averaged Clarksburg nets, Zuckerman and Evans would have received nothing, for the joint net upon which they were actually paid for 1941 was higher than the averaged Clarksburg nets for 1937 and 1938. [R. 225; Exhibit of April 13, 1950, set forth in Appendix hereto.]

The result is that as to the District Court's findings as to damage for *each* of the three critical years, the lan-

guage of the Supreme Court, speaking through Mr. Justice Brandeis, in *Keogh v. Chicago & N. W. R. R. Co.,* 260 U. S. 156, has full application:

> "Finally, not only does the injury complained of rest on hypothesis (compare *International Harvester Co. v. Kentucky,* 234 U. S. 216, 222-224); but the damages alleged are purely speculative. Under §7 of the Anti-Trust Act, as under §8 of the Act to Regulate Commerce, *Pennsylvania R. R. Co. v. International Coal Mining Co.,* 230 U. S. 184, recovery cannot be had unless it is shown, that, as a result of defendants' acts, damages in some amount susceptible for expression in figures resulted. These damages must be proved by facts from which their existence is logically and legally inferable. They cannot be supplied by conjecture . . ." (Pp. 164-165.)

For the reasons hereinabove given, it is respectfully urged that the judgment should be reversed and the cause remanded with appropriate directions to the District Court.

Respectfully submitted,

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APPENDIX.

COMPARATIVE TABULATIONS OF NET RETURNS FROM SALES OF SUGAR. [R. 222-223.]

[Exhibit of April 13, 1950]

	1937			1938			1939				1940				1941				1942		
	Crystal	Holly	Spreckels	Crystal	Holly	Spreckels	Crystal	Holly	Spreckels	Joint	Crystal	Holly	Spreckels	Joint	Crystal	Holly	Spreckels	Joint	Crystal	Holly	Spreckels
Gross receipts from sales, less cash discounts and allowances	$4.6387	$4.674	$4.6870	$4.3664	$4.225	$4.4151	$4.394	$4.261	$4.4328	$4.388	$4.450	$4.351	$4.5172	$4.455	$5.081	$5.116	$5.1550	$5.132	$5.313	$5.555*	$5.4916
Less:																					
Federal Excise Tax	.3506	.421	.3635	.5347	.534	.5350	.535	.534	.5350	.535	.535	.534	.5350	5.35	.535	.534	.5350	.535	.535	.535	.5350
Freight on sugar to destination	.2870	.284	.4482	.1912	.329	.5379	.438	.328	.5409	.479	.387	.488	.4749	.468	.322	.352	.3618	.352	.257	.373	.3741
Less sales and marketing expenses:																					
Insurance on sugar only	.0080	.015	.0060	.0159	.015	.0052	.014	.019	.0053	.009	.014	.007	.0061	.007	.007	.008	.0067	.007	.013	...	.0095
State taxes and personal property taxes on sugar	.0428	.035	.0341	.0423	.023	.0238	.047	.022	.0157	.021	.078	.020	.0271	.031	.060	.039	.0341	.040	.057	...	.0332
Storage on sugar (no charge is made for storage on sugar while in operating factory warehouses)	.0438	.023	.0293	.1085	.029	.0438	.092	.029	.0656	.060	.113	.075	.0603	.071	.052	.063	.0551	.056	.034	.	.0596
Loading, handling, reconditioning and additional cost of packing in small packages	.0828	.085	.0256	.0676	.052	.0255	.066	.048	.0519	.053	.065	.059	.0788	.071	.061	.075	.0844	.077	.076		.1015
Brokerage and Commissions	.0467	.056	.0503	.0466	.054	.0509	.048	.053	.0507	.051	.048	.052	.0507	.051	.038	.043	.0422	.042	.038		.0434
Miscellaneous, including sales department salaries and traveling expenses, advertising, telephone and telegraph expense, losses on accounts, etc.	.0653	.024	.0725	.0623	.020	.0650	.031	.017	.0640	.049	.047	.021	.0864	.061	.036	.026	.1037	.073	.057	...	.1043
Net return from sales	$3.7111	$3.731	$3.6575	$3.2973	$3.169	$3.1280	$3.123	$3.211	$3.1037	$3.131	$3.163	$3.095	$3.1979	$3.160	$3.970	$3.976	$3.9320	$3.950	$4.246	$4.047**	$4.2310

* Cash discounts not deducted. ** Without deduction for cash discounts and sales and marketing expenses.

(NOTE: Figures are per hundred pounds of sugar. [Compare R. 306, 344.]

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MANDEVILLE ISLAND FARMS, INC., a corporation, ROSCOE C. ZUCKERMAN and G. K. EVANS,

Appellees.

PETITION FOR ATTORNEY FEES ON APPEAL.

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Appellees.

PETITION FOR ATTORNEY FEES ON APPEAL.

This petition by plaintiffs (appellees herein) is filed simultaneously with the filing of their brief as appellees.

The Sherman Act provides for attorney fees to a successful plaintiff. The trial court awarded $25,000 to cover attorney fees *"up to the time of the judgment."* [Finding 20; R. 267; Supp. to appellees' brief, p. 46], which, therefore, did not cover attorney fees on this appeal. Attorney fees for this appeal should be awarded by this court. *American Can Co. v. Bruce's Juices, Inc.,* 190 F. 2d 73, 74; *Laufenberg, Inc. v. Goldblatt Bros., Inc.,* 187 F. 2d 823, 825; *Jerome v. 20th Century-Fox Film Corporation,* 165 F. 2d 784, 785. Until oral argument we will not know

the full extent of the services performed. Therefore, at the time of oral argument (unless this court selects another date) we will present to this court an affidavit setting forth the amount of services that have been performed since judgment was entered and the reasonable value thereof and we will ask this court to make an additional allowance of attorney fees in an amount shown thereby to be fair and reasonable, in accordance with the authorities above set forth and the provisions of the Sherman Act.

Respectfully submitted,

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APPELLANT'S REPLY BRIEF.

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APPELLANT'S REPLY BRIEF.

A study of appellees' brief in conjunction with a consideration of the points raised by appellant in its opening brief, indicates that the fundamental questions presented for decision by this Court are the following:

1. Did or did not the Supreme Court, in its decision in the earlier *Mandeville* appeal, 334 U. S. 219, hold that a complaint states a cause of action under the Sherman Act even though no (substantial economic) effect upon interstate commerce is alleged? (And when we say interstate commerce, so far as this appeal is concerned, we mean *sugar,* for here "the only interstate trade was in sugar": 334 U. S. 246.)

As to this first question, we will show that the Supreme Court actually *stressed* the necessity of alleging those effects upon interstate commerce which the Sherman Act condemns; and that its pronouncement as to the immateriality of the elision of the allegation charging restraints upon sugar (originally contained in Paragraph XI of the

Mandeville complaint) was predicated upon the proposition that interstate restraints were adequately charged elsewhere. ("There was more than enough without it": 334 U. S. 245, footnote 24.)

2. In order to warrant a recovery under the Sherman Act, must or must not the plaintiff allege and *prove* and the trial court *find,* that the activities complained of had a substantial economic effect upon interstate commerce?

Appellees tacitly concede that this question should be answered in the affirmative by their zeal in claiming that a misplaced finding of fact in this regard found its way into the conclusions of law at the solicitation of appellant; a contention which is adequately belied by the very pages of the record which they cite in its support. [R. 242-243.]

3. Did or did not the District Court refuse to find as to the issue of effect upon interstate commerce and clearly indicate that if it had made a finding, it would have been that the activities complained of did not affect interstate commerce?

Appellees have significantly evaded any discussion of this question.

4. Did or did not the District Court err in its application of the measure of damages to the facts of this case?

The solution of this question depends upon whether or not the evidence showed any disqualifying factor with reference to the single net figures for the critical crop years, 1939, 1940 and 1941 which would prevent their being used as the norm or standard from which to admeasure the amount of damage sustained by plaintiffs. (See, in this regard, the computations set out at page 29 of Appellant's Opening Brief.)

We now turn to a discussion of the foregoing questions.

I.

The Supreme Court Did Not Hold, in Its Decision on the Earlier Appeal in the Mandeville Case, That a Complaint States a Cause of Action Under the Sherman Act Even Though No (Substantial Economic) Effect Upon Interstate Commerce Is Alleged.

The following quotations from the majority opinion of the Supreme Court on the former appeal afford a complete answer to appellees' contention that the Supreme Court passed upon the complaint from the standpoint of a pleading charging, *without* more, a restraint as to a farm product which never crossed state lines in its original, unprocessed form:

> "We turn then to consider the questions posed upon the amended complaint that are relevant under the presently controlling criteria. These are whether the allegations disclose a restraint and monopolistic practices of the types outlawed by the Sherman Act; *whether, if so, those acts are shown to produce the forbidden effects upon commerce;** and whether the effects create injury for which recovery of treble damages by the petitioners is authorized." (334 U. S. at p. 235.)
>
> ". . . Again, as we have said, *the vital thing is the effect on commerce,* not the precise point at which the restraint occurs . . ." (334 U. S. at p. 238.)
>
> * * * * * * * *
>
> "Little more remains to be said concerning the amended complaint. *The allegations comprehend all that we have set forth.* We do not stop to restate them, leaving their substance at this point for reference to the summary made at the beginning of this opinion.

*Emphasis here, as elsewhere, is supplied unless otherwise noted.

"Respondent has presented its argument *as if the amended complaint omitted all reference to restraint or effects upon interstate trade in sugar* and confined these allegations to the trade in beets." (334 U. S. at pp. 244-245.)

* * * * * * * *

". . . The amendment did not eliminate or affect numerous other allegations *which in effect repeated the charge in various forms and with reference to various specific effects upon interstate as well as local phases of the commerce.* Some of these explicitly specified trade or commerce in sugar, *others designated the trade affected as interstate, which on the facts could mean only sugar.* Moreover, petitioners deny the disavowal, both in intent and in effect. *They say the elision* was insubstantial, since in the clause from which it was made the allegation of conspiracy to monopolize and restrain interstate commerce remained, and the only interstate trade was in sugar.* We think the amendment for whatever reason made, was not effective to constitute a disavowal, disclaimer or waiver.

"The allegations are comprehensive and, for the greater part, specific, concerning *both the restraints and their effects.* They clearly state a cause of action under the Sherman Act." (334 U. S. at p. 246; footnotes omitted.)

The short of it is that the Supreme Court clearly held that the amended complaint did allege that the activities complained of had that effect upon interstate commerce which the Sherman Act condemns.

After the coming down of the mandate on the appeal, appellant answered, putting the allegations as to inter-

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*Of the allegation originally charging a restraint as to *sugar* and sugar beets. [Complaint, Par. XI, R. 11.]

state effects directly in issue. The burden then devolved upon appellees to prove these allegations if they could. That they failed to do so is made evident from the fact that for this very reason, the District Court refused to make any finding whatever as to this pivotal issue. [R. 810, 811, 812.]

II.

In Order to Warrant a Recovery Under the Sherman Act, the Plaintiff Must Allege and Prove, and the Trial Court Find, That the Activities Complained of Had a Substantial Economic Effect Upon Interstate Commerce.

III.

The District Court Refused to Find as to the Issue of Effect Upon Interstate Commerce and Clearly Indicated That if It Had Made a Finding, It Would Have Been That the Activities Complained of Did Not Affect Interstate Commerce.

The above proposition II was discussed in appellant's opening brief at pages 16 to 19, and it is not seriously disputed by appellees. They claim, however, that Conclusion of Law No. 3 [R. 270; Appellees' Brief 18, Supp. thereto 48-49], is, in effect, a misplaced finding of fact which found its way into the conclusions of law *at the instance of appellant*. In support of this assertion they cite R. 242-243, a reference to defendant's (appellant's) objections to the second draft of plaintiff's proposed findings of fact, conclusions of law and judgment. Recourse to said objections will reveal the utter baselessness of appellees' claims in this regard. We quote from the portions of such draft material to this discussion:

> "Defendant further objects to said second draft of findings upon the ground that the same is replete with conclusions and surplusage, does not correctly

reflect the case as actually tried, and does not comply with the instructions heretofore given by the Court with reference to its preparation. In this connection defendant respectfully suggests that *in order to correctly reflect the holding of the Court,* the findings herein, the conclusions of law and the judgment to be rendered should in substance embrace the following, and that any other matters are pure surplusage and relate to matters not actually tried:

* * * * * * * *

"7. A conclusion of law to the effect that this Court regards the holding of the Supreme Court on the previous appeal binding upon it as the law of the case and *for this reason* concludes that the activities found had a substantial effect upon interstate commerce and hence comes within the purview of the Anti-Trust laws.

"8. *A conclusion of law to the effect that this Court is unable to find, from the evidence, that the activities found had any effect upon the price, supply or competitive conditions with reference to sugar.*" [R. 241-243.]

We thus perceive that appellant's suggestions were made in order to correctly reflect the holding of the District Court, which was that he did not believe that any effect upon interstate commerce had been shown. As the District Judge himself said on motion to amend the findings:

"The Court: I felt that the conspiracy between the refineries had as its real objective the control of the growers and to prevent them from dealing with the refineries that he may have wanted to deal with. In other words, that it more or less limited the grower to the place where he could sell beets and prevented any competition in that respect; but *I didn't feel that it had any effect upon the price of sugar in interstate*

commerce. That is the reason I put everything in my conclusions of law. . . ." [R. 810.]

"The Court: . . . *You will remember I cut out interstate commerce wherever I could find it.*

Mr. Arndt: That was on the basis, as I understood it, that it was a conclusion and not a statement of fact.

The Court: *I am not making a finding of fact. If I had made a finding at all I would have made a finding that it did not affect interstate commerce, but I wouldn't do that in view of the Supreme Court's decision.*" [R. 811.]

The following colloquy, which took place at the hearing of the motion in question, not only showed misgivings on the part of counsel for appellant which are fully justified by the present contentions of appellees, but also further evidences the intention of the Court to make no finding at all on the subject of interstate effects:

"Mr. Works: I think I have been very patient throughout this whole case, but Your Honor will recall we were ensnared on that first appeal by a situation where we understood and I think Your Honor understood—I know I did, that all that was alleged in that complaint—

The Court: Where I made a mistake was not trying the case first.

Mr. Works: That is true.

The Court: I thought I was doing you a favor but instead I have made a lot of extra work.

Mr. Works: I certainly don't want the same situation to happen on this forthcoming appeal that happened on the last one. *If this* is left in here there will*

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*A finding, apparently inadvertent, implying a lack of competition as to sugar interstate. It was stricken on motion of appellant. [R. 274-276.]

be an argument that Your Honor found there was a restraint of competition upon sugar, the interstate product, precisely the same thing that the Supreme Court was dealing with on the first appeal. I don't want to get caught off base again.

The Court: *I wouldn't be surprised if the court sends this case back for a specific finding of fact on the sugar, but I have felt I should not do that in view of the Supreme Court's decision."* [R. 812.]

The result is that appellees' contention that Conclusion of Law No. 3 is in reality a misplaced finding of fact on the vital issue of interstate effects, and as such made at the instance of appellant, is wholly belied by the record.

It follows further, as pointed out in appellant's opening brief, that since the District Court refused to find as to this key issue, the Court's judgment against appellant is without support from the findings and hence is not an appropriate judgment to be entered on the findings which were made, within the meaning of Rule 52 of the Federal Rules of Civil Procedure.

Counsel have not been lacking in vituperative zeal in the preparation of their appellees' brief. The fact, however, that they wholly evade any discussion whatever as to the District Court's point blank refusal to find on the issue of interstate effects amounts to a confession, without avoidance, that they have no answer to the proposition that the findings as made do not support the judgment. If there was no substantial economic effect upon interstate commerce (and the District Court *intentionally* omitted to find as to this issue), the judgment of Sherman Act violation cannot stand.

IV.

The District Court Erred in Its Application of the Measure of Damages to the Facts of These Cases.

Appellees make the point, but do not stress it, that the question of *excessive* damages cannot be raised for the first time on appeal unless a motion for new trial upon that ground has been presented to the trial court.

That question, however, is not here present. The claim is, not that the damages were excessive as such, or appeared to have been awarded as a result of passion and prejudice or the like, but rather that the Court applied the wrong *measure* of damages. This is a question of law and as such reviewable by direct appeal from the judgment, under the plain language of 28 U. S. C., Sec. 2106. Even under the former appellate practice, questions relating to the proper measure of damages were reviewable on writ of error. See, for instance, *Baltimore & Ohio C. Terminal R. Co. v. Becker Milling Machine Co.* (7 Cir.), 272 Fed. 933.

In appellant's opening brief it was argued that the proper measure of damages, translated to the facts of these cases, is the difference, trebled, between what appellees would have received had they been paid on the single net method of settlement in use before and after 1939, 1940 and 1941, over what they actually did receive under the joint settlement method actually in use in those years; *unless* appellees proved that the single net figures for those years were in some way tainted by the effects of the conspiracy.

And in this regard it will be recalled that the Supreme Court declared that the effect of the joint net method was to deprive the growers of the price (the sugar price factor

in this beet price determination formula) the individual refiner received. (334 U. S. at p. 242.) The evidence wholly fails to show that they were deprived of anything more than this.

It thus follows that the ultimate fact which the District Court was called upon to determine was the value of what appellees were deprived of by the acts of the combination; namely, *settlement on the basis of appellant's own net return from sugar,* rather than on the basis of the joint net returns of the three companies.

A similar situation was present in *Baltimore & O. C. T. R. Co. v. Becker Milling Mach. Co., supra.* The Court there said:

> "Plaintiff was given judgment for $4,010 for each machine. From evidence of demand for the machines and numerous sales by the aforesaid 'manufacturers' agents' at that unvarying price, fixed by plaintiff, the court found that such was their 'market value.' And now plaintiff contends that the judgment is unassailable because such finding of fact was not properly questioned, and because, even if it had been, it is supported by the undisputed evidence. True, the finding of 'market value' based on sales as aforesaid must stand; but the ultimate fact for the court to find as the only legal basis of recovery was the amount of money that would make plaintiff whole for the destruction of the machines. And if the uniform price that users were paying to the 'manufacturers' agents' for plaintiff's machines was not the true measure of plaintiff's loss, defendant's objections to the adoption of that standard must be considered." (272 Fed. at p. 935.)

The problem, then, so far as appellees' damages are concerned, is evaluating what they lost: settlement on the

single net method. And, by *stipulation,* appellant's single net returns for each of the three critical years were placed in evidence. These were the figures upon the basis of which settlement would have been made with appellees, unless it be shown (and, as we pointed out in appellant's opening brief, *no such showing was made*) that they were in some way tainted by the activities of the combination.

Appellees, in their present brief, expend considerable rhetoric in attempting to show that appellant's single net figures were "tainted" and "unreliable." We adopt their numbering. (Br. pp. 75-76.)

1. It is said that defendant's figures were "tainted" and "unreliable" because an inextricable part and parcel of an illegal conspiracy. Bearing in mind that the figures we are now talking about are appellant's *individual* sugar net returns (*not* the joint net figures actually used during the three critical years), there was no evidence at all that *those* figures were in any way affected by the conspiracy. In fact the situation was quite the reverse, for, as the District Court held, the sole result of the conspiracy was to effect the substitution of the joint for the individual figures. And, moreover, it should not be lost sight of, insofar as the reliability of the individual net returns were concerned, that the figures were *stipulated* to by all parties, including appellees. [R. 344.]

2. *The charge of failure to produce officers.* It is said that this "failure" requires an inference that every part of the "deal" (whatever that means) was unreliable.

In the first place, this charge is purely atmospheric, not to say disingenuous. Appellees took the depositions of everyone connected with the appellant who could possibly have had anything to do with the matter: W. N.

Wilds, President, R. 464, 469; H. E. Zitkowski, former Vice President, R. 366; E. E. Merrill, auditor, R. 442; R. H. Graham, Tax Department manager and former auditor, R. 456; W. E. Kraybill, Secretary and Treasurer, R. 495; J. A. Summerton, Vice President and Comptroller, R. 497; M. W. Hardy, Western Sales Manager, deposition R. 418, trial R. 714; J. B. Hayden, Eastern Sales Manager and subsequently Executive Vice President, deposition R. 498, trial 681; L. J. Holmes, Clarksburg factory manager, deposition R. 401, trial R. 656; which excludes C. K. Boettcher, the chairman of the Board, not shown to have had any connection with the matter, and who was in Europe. Their testimony was therefore evidence in the case, irrespective of who called them.

This and kindred animadversions on this so-called failure to call witnesses results from a misuse by appellees of the holding of the Supreme Court in the case of *Interstate Circuit v. U. S.*, 306 U. S. 208 (cited at pp. 37, 39, 47, 53, 54, 58, 59 of appellees' brief). That case holds that where the fact in issue is the existence or non-existence of the combination charged, and the proof supports an inference of such concert of action, the failure to call witnesses to deny the concerted action is in itself evidence of agreement.

The misuse by appellees of this doctrine in the present case lies in the fact that in its answers to the interrogatories and at the trial appellant *conceded* the existence of concerted action in the utilization of the joint net method of settlement with the beet growers. Appellant's answer to Interrogatory No. 87 [R. 780-781] admitted that the change to the joint net method of settlement "was made

with consultation, discussion or conference by Crystal with the other manufacturers of sugar in California north of the 36th parallel." And at the opening of the trial, counsel for appellant stated:

> "Mr. Works: I am going to be frank about that, Your Honor. I think we cannot dispute the proposition that Your Honor right now has a right to infer from these cropping contracts that there had been a combination or an agreement between the three manufacturers to use a joint or common or multiple price determination factor in arriving at the price of sugar beets." [R. 317-318.]

It will thus be perceived that appellant actually went to trial as to only two issues: (1) did the concert of action as to the beet prices have a substantial economic effect on interstate commerce (as to which the District Court intentionally omitted to make a finding) and (2) if so, what was the proper measure and amount of damages?

There was thus no reason for appellant to call any witnesses as to any issues other than these. There was certainly no occasion for appellant to call witnesses to deny the existence of a combination whose existence was conceded, and at that point the principle of the *Interstate Circuit* case ceased to have any application.

As for the *reasons* for the change, the Court was given, and accepted that of the President, W. N. Wilds. [R. 473, 810.] It declared it unsatisfactory as amounting to a stifling of competition as regards the freedom of selectivity of the beet growers; a proposition with which counsel for appellant did not disagree. [R. 731-732.]

The plain fact is that this charge of failure to produce witnesses is nothing more than an attempt by appellees to

lift themselves by their own bootstraps and thus to gloss over their failure to prove their case.

3. *The Zitkowski letter and appellees' attempts to enlarge the scope of the "conspiracy."* Appellees' arguments in this regard are contrary to the Court's findings, which were wholly directed to the price fixing of sugar *beets,* as distinguished from restraints as regards the *sugar.* [Finding 9, R. 259.] That the trial court took no stock in appellees' theories along this line is also made evident by the remarks of the District Judge, which we have heretofore quoted:

> ". . . I didn't feel that it had any effect upon the price of sugar in interstate commerce. That is the reason I put everything in my conclusions of law. . . ." [R. 810.]

4. *The evidence as to freight rates and profits.* Appellees' arguments by way of comparison as between the returns to the growers and the overall profits of appellant are nothing if not fantastic. Their barefaced and wholly unsupported assertion (Br. pp. 76-77) that appellant made over $4,000,000 from the conspiracy is equally so.

During the period in question appellant operated beet sugar factories not only at Clarksburg, but also at Oxnard, California [R. 215]; Missoula, Montana [R. 216]; Rocky Ford, Colorado [R. 217]; Grand Island, Nebraska [R. 218]; Mason City, Iowa [R. 219]; Chaska, Minnesota [R. 220], and East Grand Forks, Minnesota [R. 221]. In addition to this, the company sold beet pulp molasses, by-products of the manufacture of sugar. [R. 416, 421.]

We cannot but marvel at the recklessness of an imagination which assumes, wholly without evidence, that

the total overall profits* of a company which, among other things operated *eight* plants ranging from Oxnard and Clarksburg, California, to Chaska and East Grand Forks, Minnesota, were attributable to the utilization of a joint net mode of settlement with the growers at Clarksburg in 1939, 1940 and 1941.

This obsession of appellees with reference to the matter of overall profits results from a studied distortion of the terms "50-50" and "profit sharing" as between the company and the grower at a given factory.

What the grower shared in, both as a matter of contract and of custom in his relationship with the processor, was not the overall profits of the company from all sources and from all plants, but in the net return from sugar sold during a given crop year from the particular factory with which he dealt, according to the percentage sugar content of his beets. [See, Finding 8, R. 258; and see also, R. 406 and sugar table set forth at R. 76.] And it is of course obvious that profit or loss resulting from the manufacturing process itself, as distinguished from sales of sugar, had nothing to do with the calculation of the price to be paid for beets under the price schedules contained in the contracts. *The grower stood no part of the cost of manufacturing the sugar.* [R. 426, 637-638.]

As for the freight costs of sugar during the critical years, we certainly know what they were (Appendix, Appellant's Op. Br.), but there was not a shred of *evidence* to show that fluctuations in them were brought about by

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*Reflected in increased over-all *volume* of sales [R. 215-221, 686] resulting from lifting of quotas by the Government and from other market conditions which, at the same time, had a tendency to lower the *price* to the consumer. [R. 693-694.]

concerted action. On the other hand, appellant did prove, as was pointed out in its opening brief, that the increased freight costs were due to natural competitive conditions. [Appellant's Op. Br. pp. 27-28; R. 685-707, 716-720.] The evidence was undisputed that during the three years in question there was an abnormal supply of sugar in the Clarksburg area, resulting in heavy shipments to distant areas, with freight costs increased thereby [R. 685-687], all of which the trial court clearly understood. [R. 653-702.]

In a word, the record reveals that appellant brought itself squarely within the exception provided in *Bigelow v. RKO Pictures, Inc.*, 327 U. S. 251, 264, that declines in price, profits and values, *not shown to be attributable to other causes*, may, in a proper case, be attributed to the defendant's wrongful acts. Here, appellees did not offer any proof whatever in support of their claim [R. 424, 426-427] that appellant's freight costs were increased as a result of the "conspiracy." In addition to this, appellant did show that the freight cost factor in the sugar net receipts computation *were attributable to other causes* within the meaning of the *Bigelow* case.

And, in this connection, it is worthy of note that appellees (Br. p. 76) do not even claim to have attacked any of the other items going to make up the individual sugar net returns for 1939, 1940 and 1941. (All as shown in the appendix to appellant's opening brief.) They say they were not called upon to do so, and that they made out a *prima facie* case of damages. They refuse to face the fact, however, that the evidence showed nothing tending to impeach the stipulated individual net figures. Their *prima facie* and *ultimate* case, as to dam-

ages, was thus the difference, trebled, between what they were paid under the joint net over what they would have received under the single net method in use before and after 1939, 1940 and 1941. After all, the question for decision in this regard is what appellees would have received but for the "conspiracy"; and as to this, under the evidence in the record, there can be but one answer: *payment on the individual or single net basis.*

5. Appellees cite *Story Parchment Co. v. Paterson Parchment Paper Co.,* 282 U. S. 555, 561, to the point that the natural and probable effect of the combination would be to destroy normal (beet) prices. This may be true; but the question here is, to what extent?

The claim is also made that it was not necessary for appellees to show that appellant's individual net for the critical years was tainted or rendered unreliable by the concerted action, since the individual net computed in the same way it was computed both before and after 1939, 1940 and 1941 was not a market value, and hence it is proper to utilize the figures for other years in arriving at an estimate of damages.

In attempting to justify the use of figures for other years, however, appellants industriously ignore the fact that the use of such a yardstick is the exception, not the rule. Such evidence is permitted only where the nature of the wrong is such as to preclude more precise proof. (*Bigelow v. R.K.O. Radio Pictures, supra; Story Parchment Co. v. Paterson, supra; Eastman Kodak Co. v. Southern Materials Co.,* 273 U. S. 359.) As said in the *Bigelow* case:

> "The comparison of petitioners' receipts before and after respondents' unlawful action impinged on peti-

> tioners' business afforded a sufficient basis for the jury's computation of the damage, where the respondents' wrongful action *had prevented petitioners from making any more precise proof of the amount of the damage.*" (327 U. S. at p. 266.)

Under no rational theory may it be said here that precise proof of appellees' damages was *prevented* by any act of appellant. As heretofore pointed out, the single net figures were *stipulated* to; and it was therefore error for the District Court not to have used them in arriving at the respective amounts of damages awarded by it.

Conclusion.

It will be recalled that in appellant's opening brief (p. 14), the point was made that a determination by an appellate court that a complaint states a cause of action constitutes the law of the case only to the extent that the allegations thereof, deemed to be true on the former appeal, are substantiated by *proof*. This legal proposition is not controverted by appellees.

The refusal of the District Court to make a finding as to the issue of interstate effects stands as irrefutable evidence that appellees failed, *by proof,* to substantiate their allegations in this respect. It therefore follows that the pronouncements of the Supreme Court on the former appeal as to this subject do not constitute the law of the case, despite appellees' protestations to the contrary. The Court was there dealing only with facts *alleged;* and this is made doubly evident when, as we have seen, it said in the closing

portions of the opinion: *"The allegations comprehend all that we have set forth."* (334 U. S. at p. 244.)

We have taken neither the time nor the space to answer in detail the many assertions in appellees' brief with which we might well take issue. There are, however, one or two matters which warrant direct challenge.

In an attempt to impeach appellant's freight figures appellees assert that Clarksburg's 1939 production and sales dropped from those of 1938. This is incorrect. Clarksburg's production and sales for 1938 were, respectively, per 100-pound bags, 580,431 and 390,385; in 1939 they jumped to 848,706 and 816,561.* [Deft. Ex. C; and see discussion at R. 686.] There was thus no question of an increase of freight costs on decreased sales, as appellees would have the Court believe. (Appellees' Br. p. 56.)

At page 60 of the supplement to appellees' brief, and in connection with their discussion of hypothetical damages, another patently incorrect statement is made as regards the "carry-over" of sugar from one year to the next. It is there stated that the company received the entire benefit of any price increases in the carry-over year. The trial court did not so find, and the evidence is to the contrary. As the District Court itself pointed out:

> "The Court: As a matter of fact, under that system, on the crop he sold in 1939, would he not profit by increase in prices from 1938?
>
> The Witness: That is right, yes." [R. 667.]

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*The delivery figures referred to by counsel for appellees at R. 720 were northern California deliveries only. The over-all Clarksburg sales figures for the years in question are as we have set them out above.

For the reasons hereinabove given and for the reasons set forth in appellant's opening brief herein, it is respectfully urged that the portions of the judgment appealed from should be reversed.

Respectfully submitted,

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PIERCE WORKS,
Attorneys for Appellant.

DONALD S. GRAHAM,
LEWIS, GRANT, NEWTON, DAVIS & HENRY,
O'MELVENY & MYERS,
Of Counsel.

No. 12946.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

AMERICAN CRYSTAL SUGAR COMPANY, a corporation,
Appellant,

vs.

MANDEVILLE ISLAND FARMS, INC., a corporation, ROSCOE C. ZUCKERMAN and G. K. EVANS,
Appellees.

AFFIDAVIT IN SUPPORT OF PETITION FOR ATTORNEY FEES ON APPEAL.

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AFFIDAVIT IN SUPPORT OF PETITION FOR ATTORNEY FEES ON APPEAL.

State of California, County of Los Angeles—ss.

STANLEY M. ARNDT, being first duly sworn, deposes and says:

Appellees herein, simultaneously with the filing of their brief as appellees, filed their petition for attorney fees on appeal, wherein it was stated:

> "The Sherman Act provides for attorney fees to a successful plaintiff. The trial court awarded $25,000 to cover attorney fees *'up to the time of judgment.'* [Finding 20; R. 267; Supp. to appellees' brief, p. 46], which, therefore, did not cover attorney fees on this appeal. Attorney fees for this appeal should be awarded by this court. *American Can Co. v. Bruce's Juices, Inc.,* 190 F. 2d 73, 74;

Laufenberg, Inc. v. Goldblatt Bros., Inc., 187 F. 2d 823, 825; *Jerome v. 20th Century-Fox Film Corporation,* 165 F. 2d 784, 785. Until oral argument we will not know the full extent of the services performed. Therefore, at the time of oral argument (unless this court selects another date) we will present to this court an affidavit setting forth the amount of services that have been performed since judgment was entered and the reasonable value thereof and we will ask this court to make an additional allowance of attorney fees in an amount shown thereby to be fair and reasonable, in accordance with the authorities above set forth and the provisions of the Sherman Act."

However, in order to give appellant an opportunity to check the figures herein presented and to reply prior to the time of oral argument, we serve and file this affidavit at the present time.

Affiant at all times during the progress of this litigation was, and now is, an attorney at law duly admitted to practice before the District Courts of the United States in and for the Southern District of California and the Northern District of California, the Court of Appeals for the Ninth Circuit, the Supreme Court of the United States, all of the state courts of New York and California, etc. Affiant has been a California practicing attorney since 1920. Affiant has served as Special Master in various cases under appointment by the United States District Court for the Southern District of California and has written various articles on legal subjects that appeared in the California Law Review and various other legal periodicals and has personally handled many appeals involving intricate and difficult legal questions.

Affiant has handled these causes on behalf of plaintiffs below from the original investigation of the facts prior to filing suit, through the first series of appeals to the Supreme Court, and up to and including the present time.

The firm of attorneys representing appellant is one of the most distinguished, experienced and able law firms in California.

Appellants herein filed their notice of appeal with the Clerk of the District Court on March 28, 1951. Affiant has spent 176 hours in connection with this appeal and the matters involved therein since March 28, 1951, and expects to spend further time in preparing for argument and in argument. Affiant has office records kept in the usual course of business showing the details of this time record and such records are open to the inspection of counsel for appellant or their accountants at any reasonable time or times prior to the oral argument for the purpose of permitting appellant to check such time records.

Affiant's usual and regular charge for his services for ordinary run of the mill office work is, and at all times since March 28, 1951, has been $30 an hour. Affiant recognizes that the time involved is but one of the elements to be considered.

Affiant is familiar with the elements recognized in determining proper and reasonable attorney fees by this court (*Sampsell v. Monell,* 162 F. 2d, 4, 6) by the California state courts (*3 Cal. Jur.* p. 698, *1 Cal. Jur. 10-yr. Supp.* p. 831) and by the general authorities on the subject (*7 C. J. S.* p. 1080, *et seq.*).

Giving due consideration to each of the elements recognized by the above authorities in determining proper

and reasonable attorney fees, it is the opinion of affiant that the reasonable value of affiant's services in connection with this appeal, including the time that should be reasonably necessary to prepare for argument and appearance on oral argument and argument of this cause on oral argument in San Francisco on February 4, 1952, is $6,000.00.

Wherefore, affiant prays that this court award respondents the sum of $6,000.00 as attorney fees on this appeal.

STANLEY M. ARNDT.

Subscribed and sworn to before me this 21st day of January, 1952.

(seal) C. O. BURCH,

Notary Public in and for said County and State.

No. 12950

United States
Court of Appeals
For the Ninth Circuit.

NORTH UMBERLAND MINING COMPANY, a Corporation,

Appellant,

vs.

STANDARD ACCIDENT INSURANCE COMPANY, a Corporation,

Appellee.

Transcript of Record

**Appeal from the United States District Court,
Southern District of California,
Central Division.**

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12950

United States
Court of Appeals
For the Ninth Circuit.

NORTH UMBERLAND MINING COMPANY, a Corporation,

Appellant,

vs.

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Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

For Appellant:

DONALD ARMSTRONG,
1308 Sartori Ave.,
Torrance, Calif.

For Appellee:

BAUDER, GILBERT, THOMPSON & KELLY,
939 Rowan Bldg.,
Los Angeles 13, Calif.

In the District Court of the United States, Southern District of California, Central Division
No. 5729 C

STANDARD ACCIDENT INSURANCE COMPANY OF DETROIT, a Corporation,
Plaintiff,

vs.

HOME INDEMNITY COMPANY OF NEW YORK, a Corporation, GEORGE WHITE, JAMES CARL FITZGERALD, JAMES RICHARD OSBORNE, MICHAEL LEE and PATRICIA LEE,
Defendants.

NORTH UMBERLAND MINING COMPANY, a Corporation,
Intervener.

COMPLAINT IN INTERVENTION

The above-entitled Court by order heretofore made having granted intervener leave to intervene, intervener for complaint in intervention alleges:

I.

Intervener at all times herein mentioned was, and now is, a corporation organized and existing under and by virtue of the laws of the State of Nevada and is a citizen and resident of said state.

II.

That plaintiff, Standard Accident Insurance Company of [2*] Detroit, a corporation, at all times

*Page numbering appearing at foot of page of original Certified Transcript of Record.

herein mentioned was, and now is, a corporation organized and existing under and by virtue of the laws of the State of Michigan and is a citizen and resident of said state.

III.

That the defendant, Home Indemnity Company of New York, a corporation, at all times herein mentioned was, and now is, a corporation organized and existing under and by virtue of the laws of the State of New York, and is a citizen and resident of said state.

IV.

That at all times herein mentioned defendants, George White, James Carl Fitzgerald, James Richard Osborne, Michael Lee and Patricia Lee, were, and now are, residents and citizens of the State of California residing in the Southern District of California.

V.

That the amount in controversy in this action exceeds the sum of $3000.00 exclusive of interest and costs.

VI.

That intervener, North Umberland Mining Company, on and prior to the 20th day of July, 1946, was the owner of the Lincoln Zephyr automobile mentioned in paragraph VIII of plaintiff's complaint filed in the within action.

VII.

That intervener is informed and believes, and

therefore alleges, that on the 20th day of July, 1946, defendant, George White, was driving the Lincoln Zephyr automobile described in paragraph VI hereof in the County of San Diego, State of California, with the consent of said intervener and did then and there run into and collide with one Claude McLester Lee and one Leana Mae Osborne Lee, and as a result of the injuries sustained in said collision said Claude McLester Lee and said Leana Mae Osborne Lee died. [3]

VIII.

That on or about the 6th day of August, 1946, defendants, Michael Lee and Patricia Lee, commenced an action in the Superior Court of the State of California, in and for the County of San Diego, entitled "Michael Lee, a minor, and Patricia Lee, a minor, by Mildred E. Taylor, their Guardian ad litem, Plaintiffs, vs. George White, John Doe and Doe Corporation, a corporation, Defendants," being numbered No. 134918 in the files of said court, and that in the complaint filed by them in said action the said plaintiffs alleged that they were the children of said Claude McLester Lee and his sole surviving heirs at law; that the death of said Claude McLester Lee was caused by the negligence of the defendant, George White, while operating a Lincoln Zephyr automobile hereinbefore in paragraph VI described, and that by reason of the death of said Claude McLester Lee they were damaged in the sum of $50,000.00.

IX.

That on or about the 1st day of August, 1946, defendants, James Carl Fitzgerald and James Richard Osborne, commenced an action in the Superior Court of the State of California, in and for the County of San Diego, entitled "James Carl Fitzgerald, a minor, by and through his Guardian ad litem, James Richard Osborne, and James Richard Osborne, Plaintiffs, vs. George White and North Lumberland Mining Company, Defendants," being numbered No. 134630 in the files of said court, and that in the complaint filed by them in said action the said plaintiffs alleged that defendant, James Carl Fitzgerald, was the son of the aforesaid Leana Mae Osborne Lee, and that James Richard Osborne was the father of said Leana Mae Osborne Lee, and that said James Carl Fitzgerald is the sole heir at law of said Leana Mae Osborne Lee; that the death of said Leana Mae Osborne Lee was caused by the negligence of the defendant, George White, while operating a Lincoln Zephyr automobile hereinbefore in [4] paragraph VI described, and that by reason of the death of said Leana Mae Osborne Lee they were damaged in the sum of $50,500.00.

X.

That thereafter intervener was duly and regularly served with a copy of the complaint and summons in each of the actions referred to in paragraphs VIII and IX hereof; that thereafter and within the time allowed by law intervener filed its answer in each of said actions.

XI.

That thereafter and on January 19, 1948, in said action No. 134630, judgment was entered in favor of plaintiffs therein and against defendants, George White and North Umberland Mining Company, in the sum of $4,000.00; that thereafter and on January 19, 1948, in said action No. 134918 judgment was entered in favor of plaintiffs therein and against defendants, George White and North Umberland Mining Company, in the sum of $4750.00; that thereafter and on January 19, 1948, defendant, North Umberland Mining Company, paid and satisfied each of said judgments by paying to plaintiffs in said action No. 134630 the sum of $4000.00 and to plaintiffs in action No. 134918 the sum of $4750.00.

XII.

Intervener incorporates by reference paragraphs VIII, IX, X, XI, XII, and XIII of plaintiff's complaint on file in the within cause.

XIII.

A controversy exists between plaintiff, Standard Accident Insurance Company of Detroit, defendant, George White, and intervener, North Umberland Mining Company, in that intervener is informed and believes that George White claims, and intervener claims, that plaintiff, Standard Accident Insurance Company of Detroit, is liable under the policy described in paragraph XI of plaintiff's [5] complaint herein for any money which defendant, George White, is required to pay intervener by rea-

son of the payment and satisfaction of the judgments as aforesaid, and plaintiff claims that it is not liable or required to pay intervener by reason of the payment and satisfaction of the judgments aforesaid; intervener claims that defendant, George White, is liable to it in the sum of $8750.00 by reason of its having paid and satisfied the judgments aforesaid, and said George White claims that he does not owe intervener anything on account of its having paid and satisfied said judgments.

XIV.

That intervener's claim is based upon common questions of law and fact involved in the main action.

Wherefore, intervener prays for a decree as follows:

1. For a declaration of the respective rights, duties and liabilities of intervener, North Umberland Mining Company, defendant, George White, and plaintiff, Standard Accident Insurance Company of Detroit.

2. That the court declare that the defendant, George White, is obligated to intervener in the sum of $8750.00, together with interest thereon at the rate of seven (7) per cent per annum from and after January 19, 1948.

3. That this court declare that plaintiff, Standard Accident Insurance Company of Detroit, is obligated to George White in the sum of $8750.00, together with interest thereon at the rate of seven

(7) per cent per annum from and after January 19, 1948, under the terms of its policy which said policy is attached to plaintiff's complaint in the within action and marked "Exhibit A."

4. For intervener's costs and for such other and further relief as shall seem just and equitable.

/s/ DONALD ARMSTRONG,
Attorney for Intervener.

Affidavit of Service by Mail attached.

[Endorsed]: Filed June 11, 1950. [6]

[Title of District Court and Cause.]

ANSWER OF STANDARD ACCIDENT INSURANCE COMPANY OF DETROIT TO COMPLAINT IN INTERVENTION

Comes now plaintiff, Standard Accident Insurance Company of Detroit, a corporation, and answering the complaint in intervention of intervener, North Umberland Mining Company, a corporation, alleges as follows:

I.

Plaintiff admits the allegations contained in paragraphs I, II, III, IV, V, VI, VII, VIII, IX, X, XII, XIII and XIV of the complaint in intervention. [9]

II.

Answering paragraph XI, plaintiff admits that

on or about the dates therein alleged judgments were entered in the actions therein described and in the amounts therein set forth, and upon information and belief alleges the facts to be that North Umberland Mining Company, a corporation, did not pay either or both of said judgments or amounts therein alleged and in that regard alleges that said judgments and the amounts therein set forth were paid by defendant Home Indemnity Company of New York, a corporation, pursuant to its policy of automobile liability insurance referred to and described in plaintiff's complaint and issued to intervener Northumberland Mining Company, a corporation. Further answering said paragraph this answering plaintiff alleges that each and both of said judgments were entered pursuant to a stipulation for the entry of said judgments and without the consent or approval of this answering plaintiff.

III.

Further answering the complaint in intervention, this plaintiff admits that a controversy does exist as described in intervener's complaint and in that regard this plaintiff contends that if said George White did, after the occurrence of the accident described and referred to in the complaint in intervention, breach the terms of the policy issued by Home Indemnity Company of New York on his part to be performed, and did thereby release and excuse Home Indemnity Company of New York from its obligations under said policy, then defend-

ant George White was and is obligated to pay any expense incurred in the defense of either or both of said actions referred to in the complaint in intervention, and to pay any judgments rendered against him therein up to but not beyond the amount which except for said breach of said policy defendant Home Indemnity Company of New York would have been obligated to pay, and that said plaintiff was not obligated to defend either or both of said actions [10] or to pay any portion of either or both of said judgments, and that plaintiff further contends that if defendant George White failed to cooperate with defendant Home Indemnity Company of New York and did thereby breach the terms and conditions of the policy issued by defendant Home Indemnity Company of New York, he likewise failed to cooperate with this plaintiff under and in accordance with the terms of its policy referred to and described in the complaint in intervention and annexed as an exhibit to plaintiff's complaint in the above-entitled action, and that this plaintiff has by reason of such failure of cooperation been released from any obligation under its policy.

IV.

Denies that this answering plaintiff is indebted or obligated to intervener, Northumberland Mining Company, a corporation, or to defendant George White, or either of them, in the sum or sums referred to in the complaint on file herein, or in any other sum or sums whatsoever, or at all.

Wherefore, plaintiff prays:

(1) For a declaration of the respective rights, duties and liabilities of the intervener, Northumberland Mining Company, defendant, George White and plaintiff, Standard Accident Insurance Company of Detroit;

(2) That if this court find and so decree that defendant, George White, has breached the conditions of the policy of insurance issued by Home Indemnity Company of New York, which is described in the complaint on file herein and referred to and made a part of the complaint in intervention, and that thereby Home Indemnity Company of New York has been released from its obligations to the defendant, George White, thereunder, then this court adjudge and declare that this plaintiff was not obligated to defend action No. 134918 or said action No. 134630, or either of them, but that its [11] sole obligation under its said policy, if this court decrees that defendant George White did not breach the policy issued to him by plaintiff, was to pay only such portion of any judgment or judgments that might be rendered against said George White, after a trial on the merits of any action commenced against him, or after judgment entered pursuant to any stipulation agreed to by this plaintiff, as shall be in excess of the insurance that would have been available to said George White had he not breached the terms and conditions of said policy of insurance issued by defendant Home Indemnity Company of New York as in the complaint alleged, and in the complaint in intervention referred to;

(3) That this court find, declare and decree that plaintiff, Standard Accident Insurance Company of Detroit, under the facts alleged and referred to in the complaint in intervention, is not obligated in any amount whatsoever to intervener, Northumberland Mining Company, a corporation, or to defendant George White, or either of them, in the sum or sums referred to in the complaint in intervention, or in any other sum or sums whatsoever, or at all.

(4) For costs of suit and such other and further relief as shall seem just and equitable.

BAUDER, GILBERT,
THOMPSON & KELLY,

By /s/ EVERETT W. THOMPSON,
Attorneys for Plaintiff Standard Accident Insurance Company of Detroit, a Corporation.

Affidavit of Service by Mail attached.

[Endorsed]: Filed August 22, 1950. [12]

[Title of District Court and Cause.]

MEMORANDUM OF POINTS AND AUTHORITIES IN RE ISSUES RAISED BY COMPLAINT IN INTERVENTION AND ANSWERS THERTO

Statement of Facts

For a full detailed statement of all facts established in the main action we refer the court to the

case of Home Indemnity Company of New York v. Standard Accident Insurance Company, 167 Fed. (2) 919. For convenience and brevity herein, the Home Indemnity Company of New York will be referred to as "Home" and the Standard Accident Insurance Company of Detroit as "Standard," and Mr. George White as "White."

The complaint in intervention and answers thereto, we believe, do not at this time require a detailed statement of all of the facts contained in the reported case, but in order to [14] properly determine the questions involved they do require a brief statement of basic facts that pertain to the intervention proceeding.

Briefly, the essential facts are that after the United States District Court, in the main action for declaratory relief, ruled that Home was obligated under its policy to defend and indemnify White in the actions brought against him in the Superior Court of San Diego County, Home, pursuant to a stipulation for judgment entered into between counsel representing the plaintiffs in the state court actions and counsel employed by Home and representing the intervener (who was a defendant in the state court action), and separate counsel representing defendant White, but not with consent of or pursuant to any stipulation entered into by counsel representing Standard, stipulated that judgments be entered in favor of the plaintiffs in the state court actions and against the intervener, North Umberland Mining Company, a corporation, and White. The judgments so stipulated were entered

at the time and in the sums mentioned in the complaint in intervention. Home paid and satisfied the stipulated judgments entered against its named insured, North Umberland Mining Company. Thereafter the United States Court of Appeals for the Ninth Circuit reversed the judgment entered in the District Court and held that as the result of the failure of White to cooperate with Home following the automobile accident which gives rise to the causes of action commenced in the state court, it was not obligated or required to defend or indemnify White in either of said actions. According to the late Federal Judge J. F. T. O'Connor, in a memorandum decision by him in this case following the decision of the United States Court of Appeals, the only issue that was decided in the declaratory relief action and by the United States Court of Appeals was whether or not Home was required to defend and indemnify White in the state court actions (see Standard v. Home, 82 Fed. Supp. 945). He states no other issue was decided. [15]

Plaintiff in intervention now seeks a judgment in this court declaring the rights, duties and liabilities, if any, of the various parties and that the court declare that White is obligated to intervener in the sums referred to in the complaint and that Standard is obligated to White under the terms of the policy issued by Standard and marked "Exhibit A" attached to the Standard complaint in the main action.

Standard denies that it is obligated to intervener or its indemnitor, Home, in the sums referred to

in the complaint or in any other sum or sums whatsoever, or at all. Standard's contentions, among others, are that at the time of the accident the Home policy afforded White valid and collectible insurance up to the limits stated in the policy and that the insurance afforded White under the Standard policy at the time of the accident clearly was only excess insurance, and that White by his voluntary breach of the cooperation clause of the Home policy cannot prejudice the rights of Standard.

The Home policy provided coverage far exceeding the total prayers for judgment in the state court actions and which insurance under the Home policy would have been available and would have satisfied any judgment entered or prayed for in the state court actions had it not been for the voluntary lack of cooperation on the part of White.

Memorandum of Law Involved

Point I.

It cannot be disputed that at the moment that the accident occurred, and probably from the time White got into the intervener's automobile, the Home policy was existing and primary insurance in full force and effect and the Standard policy solely excess insurance.

Zurich v. Clamor,
124 Fed. (2) 717; [16]
Gutner v. Switzerland,
32 Fed. (2) 700;
Air Transport v. Employers, etc.,
91 C.A. (2) 129, at 131; 204 Pac. (2) 647;
See our comment on page 7;

Gillies v. Michigan Millers, etc., Ins. Co. (Aug. 18, 1950), 98 A.C.A. 959, at 957;
Maryland Casualty Co. v. Hubbard, 22 Fed. Supp. 697 (1938, U.S.D.C., Judge Yankwich);
Couch on Insurance, Vol. 5, page 3636, note 12;
Lehigh Valley, etc., v. Providence, etc., 127 Fed. 364.

The only reasonable interpretation that can be given to the Home policy and the Standard policy as of the moment of the occurrence of the accident which gave rise to the cause of action asserted in the state courts is that the Home policy was primary insurance up to the limits therein specified and the Standard policy was solely excess insurance over and above the limit afforded under the Home policy.

This conclusion is irresistible and arises out of the undisputed facts that at the time of the accident White was operating the vehicle insured by the Home policy and described in its policy and registered to the Home insured. He was operating it with the permission and consent of the Home insured, and therefore became an insured under said policy (see Home policy Insuring Agreement III). He had all the benefits flowing to an insured under said policy.

White was not operating a vehicle registered to or owned by him and described in his policy with Standard. The only clause of the Standard policy which gave White any protection at the time of the

accident was the clause referred to under Insuring Agreement VIII, entitled "Temporary Use of Substitute Automobile," and which agreement is and was controlled by Condition 13 of said policy, [17] which provides in part:

> "* * * The insurance under Insuring Agreements VI and VIII shall be excess insurance over any other valid and collectible insurance available to the insured, either as an insured under a policy applicable with respect to the automobile or otherwise, against a loss covered under either or both of said Insuring Agreements."

The only event that caused the Home policy to subsequently be declared unavailable to White was his voluntary breach of its conditions.

Point II.

The Home policy was valid and collectible insurance available to White.

In American Lumbermen's etc., v. Lumber Mutual Casualty Co., 295 N. Y. S., 321, at page 324, the court says:

> "We interpret the words 'total amount of collectible and valid insurance' to mean insurance which is capable of protecting the insured. It merely excludes invalid or illegal insurance (such as insurance which is voidable for misrepresentation) and uncollectible insurance (such as insurance of an insolvent company) from the computation of total insurance for the

purposes of apportionment. These words were so construed by this court in Balzer v. Globe Indemnity Co., 206 N. Y. S. 777, in in Lamb v. Belt Casualty Co., 3 C.A. (2) 624, 40 Pac. (2) 311, and the same interpretation was adopted by the California court. [18]

Point III.

White's voluntary breach of the cooperation clause of the Home policy should not be permitted to prejudice the rights of Standard.

It has been clearly established that at the time of the accident the Home policy specifically covered the car operated by White, was valid and collectible primary insurance, and that White was an insured under the Home policy by its express terms. It has also been shown that the only insurance at the time of the accident Standard afforded to White was excess insurance over and above the limits stated in the Home policy and that the loss did not exceed such limits. This is not a case wherein for some failure on the part of the Home insured to pay a premium or because of a breach of a warranty, or because of the insolvency of Home at the time of the accident the Home policy had become invalid or uncollectible. It is simply and only a case wherein White's voluntary act constituted lack of cooperation and therefore a breach of the condition of the Home policy. Standard's rights should not be prejudiced thereby.

The policies issued by Home and Standard were issued in contemplation that the assured would

comply with the conditions on his part to be performed under the policy. It should take little argument to convince a reasonable mind that the premium exacted by Standard of White would have been much greater indeed had Standard ever contemplated that a voluntary act on behalf of its insured would ipso facto convert that which is expressly declared in the policy to be excess insurance into primary insurance. If an insured by his voluntary act releases one insurer of any obligation under its policy, by the same token the rights of the excess insurer should not be permitted in law, equity or good conscience to be prejudiced and defeated by such voluntary act. The insured should bear the loss, not the innocent carrier. The rights of the intervener are no [19] greater than the rights of the insured insofar as an interpretation of the provisions of each policy is concerned (See 167 Fed. (2) 919, at 929).

If White by his voluntary act chooses to breach the Home policy, Standard should not be compelled or obligated thereby to pay any portion of any judgment secured against White or the insured under the Home policy by stipulation or otherwise until White has paid on said judgment the amount of the liability of Home as expressed in its policy limits and which was available and would have been paid under its just contractual obligation had it not been for the voluntary act of White.

The Air Transport Case

We believe that the reasoning and logic employed in the Air Transport case (91 C.A. (2) 129) is ap-

plicable to the case at bar. In the first place, the court in the cited case states on page 131 as follows:

> "To determine the liability of Employers at this time, if any, we must first determine the respective liabilities, if any, of Employers and Pacific Indemnity at the date of the accident." (Emphasis ours.)

Substituting Home and Standard for Employers and Pacific Indemnity, respectively, one can only come to the conclusion that the liabilities of Home and Standard, if any, must be determined as of the date of the accident in question. Further, if one substitutes primary and excess insurance in place of concurrent insurance into the reasoning of the cited case and puts Home in the place of Pacific Indemnity Company in that case, and Standard in the place of Employers, it would seem to follow logically and naturally that the obligation of Standard as an excess carrier became fixed no later than at the time of the accident and remained in that category even though the insured, White, forfeited his [20] rights under the Home policy.

Inasmuch as the limits of liability under the Home policy at the time of the accident far exceeded the judgments prayed for or entered in the state court actions, and similarly the claims of the intervener herein, and inasmuch as the insurance afforded by Home was valid and collectible at the time of the accident and was primary insurance, and that afforded by Standard at the time of the accident was solely and exclusively excess insurance, it is sub-

mitted that Standard should not be compelled to pay any portion or part of the judgments entered in the state court actions, and for which intervener seeks judgment in this proceeding, and, further, that the judgment of this court should and must be in favor of Standard.

Respectfully submitted,

BAUDER, GILBERT,
THOMPSON & KELLY,

By /s/ EVERETT W. THOMPSON,
Attorneys for Plaintiff.

[Endorsed]: Filed December 14, 1950. [21]

At a stated term, to wit: The February Term, A. D. 1951, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Wednesday, the 3rd day of January, in the year of our Lord one thousand nine hundred and fifty-one.

Present: The Honorable James M. Carter,
District Judge.

[Title of Cause.]

MINUTE ORDER

This cause having been heard and submitted to the Court, and the Court having duly considered the matter, the Court now finds for and against the re-

spective parties as follows, and it is ordered that findings of fact, conclusions of law and judgment be drawn accordingly:

(1) The Court finds in favor of the intervening plaintiff North Umberland Mining Company and against the defendant George White, and that said intervening plaintiff is entitled to recover the sum of $8,750.00, together with interest at 7% from January 19, 1948, and costs herein, from said defendant;

(2) The Court finds that the plaintiff Standard Accident Insurance Company is not obligated to anyone on its policy, without costs.

(3) The Court finds that the defendant Home Indemnity Company is not obligated to anyone on its policy, without costs.

(4) The action having become moot as to the defendants Fitzgerald, Osborne, Michael Lee, Patricia Lee and Taylor, no relief will be granted as to these defendants.

(5) The Court adopts the memorandum of Bauder, Gilbert, Thompson and Kelly, filed December 14, 1950, as reflecting its reasoning, to aid counsel in preparing findings, conclusions and judgment in lieu of a formal Opinion. Counsel for North Umberland Mining Company will prepare and present findings of fact, conclusions of law and judgment pursuant to Local Rule 7, within 10 Days. [22]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This action having come on regularly for trial on December 22, 1950, before the above-entitled court, the Honorable James M. Carter, Judge, presiding, upon the complaint in intervention of North Umberland Mining Company, Intervener, and the answer of plaintiff, Standard Accident Insurance Company of Detroit, thereto and the answer of the defendant, George White, thereto, and oral and documentary evidence having been introduced by the respective parties, and the cause having been argued and submitted to the [23] Court for decision, the Court, now being fully advised and informed in the premises, makes the following findings of fact:

I.

Intervener at all times herein mentioned was, and now is, a corporation organized and existing under and by virtue of the laws of the State of Nevada and is a citizen and resident of said state.

II.

That plaintiff, Standard Accident Insurance Company of Detroit, a corporation, at all times herein mentioned was, and now is, a corporation organized and existing under and by virtue of the laws of the State of Michigan and is a citizen and resident of said state.

III.

That the defendant, Home Indemnity Company

of New York, a corporation, at all times herein mentioned was, and now is, a corporation organized and existing under and by virtue of the laws of the State of New York, and is a citizen and resident of said state.

IV.

That at all times herein mentioned defendants, George White, James Carl Fitzgerald, James Richard Osborne, Michael Lee and Patricia Lee, were and now are, residents and citizens of the State of California, residing in the Southern District of California.

V.

That the amount in controversy in this action exceeds the sum of $3000.00 exclusive of interest and costs.

VI.

That on and prior to the 20th day of July, 1946, intervener, North Umberland Mining Company, was the owner of a certain Lincoln Zephyr automobile, and that prior to said 20th day [24] of July, 1946, defendant, Home Indemnity Company of New York, issued in the State of Nevada to said North Umberland Mining Company its policy of automobile liability insurance, which said policy is attached to and made a part of the answer of defendant, Home Indemnity Company of New York.

VII.

That on the 20th day of July, 1946, defendant, George White, was driving the Lincoln Zephyr automobile described in paragraph VI hereof in the

County of San Diego, State of California, with the consent of said intervener and did then and there run into and collide with one Claude McLester Lee and one Leana Mae Osborne Lee, and as a result of the injuries sustained in said collision said Claude McLester Lee and said Leana Mae Osborne Lee died.

VIII.

That on or about the 6th day of August, 1946, defendants, Michael Lee and Patricia Lee, commenced an action in the Superior Court of the State of California, in and for the County of San Diego, entitled "Michael Lee, a minor, and Patricia Lee, a minor, by Mildred E. Taylor, their Guardian ad litem, Plaintiffs, vs. George White, John Doe and Doe Corporation, a corporation, Defendants," being numbered No. 134918 in the files of said court, and that in the complaint filed by them in said action the said plaintiffs alleged that they were the children of said Claude McLester Lee and his sole surviving heirs at law; that the death of said Claude McLester Lee was caused by the negligence of the defendant, George White, while operating a Lincoln Zephyr automobile hereinbefore in paragraph VI described, and that by reason of the death of said Claude McLester Lee thy were damaged in the sum of $50,000.00.

IX.

That on or about the 1st day of August, 1946, defendants, [25] James Carl Fitzgerald and James Richard Osborne, commenced an action in the Superior Court of the State of California, in and for

the County of San Diego, entitled "James Carl Fitzgerald, a minor, by and through his Guardian ad litem, James Richard Osborne, and James Richard Osborne, Plaintiffs, vs. George White and North Umberland Mining Company, Defendants," being numbered No. 134630 in the files of said court, and that in the complaint filed by them in said action the said plaintiffs alleged that defendant, James Carl Fitzgerald, was the son of the aforesaid Leana Mae Osborne Lee, and that James Richard Osborne was the father of said Leana Mae Osborne Lee, and that said James Carl Fitzgerald is the sole heir at law of said Leana Mae Osborne Lee; that the death of said Leana Mae Osborne Lee was caused by the negligence of the defendant, George White, while operating a Lincoln Zephyr automobile hereinbefore in paragraph VI described, and that by reason of the death of said Leana Mae Osborne Lee they were damaged in the sum of $50,500.00.

X.

That thereafter intervener was duly and regularly served with a copy of the complaint and summons in each of the actions referred to in paragraphs VIII and IX hereof; that thereafter and within the time allowed by law intervener filed its answer in each of said actions.

XI.

That thereafter and on January 19, 1948, in said action No. 134630, judgment was entered in favor of plaintiffs therein and against defendants, George

White and North Umberland Mining Company, in the sum of $4,000.00; that thereafter and on January 19, 1948, in said action No. 134918 judgment was entered in favor of plaintiffs therein and against defendants, George White and North Umberland Mining Company, in the sum of $4750.00; that thereafter and on January 19, 1948, defendant, North Umberland [26] Mining Company, paid and satisfied each of said judgments by paying to plaintiffs in said action No. 134630 the sum of $4000.00 and to plaintiffs in action No. 134918 the sum of $4750.00, and that defendant, George White, has never paid anything on account of said judgments to anyone. That each of said judgments herein described was entered without a trial on the merits of either action and pursuant to a stipulation entered into between counsel representing the plaintiffs in each of said state court actions and counsel employed by defendant George White and counsel representing the intervener, and that plaintiff did not agree to or stipulate to either of said judgments; that defendant Home Indemnity Company of New York did pay and satisfy each of said judgments for and on behalf of its named insured, the intervener.

XII.

That said Home Indemnity Company of New York did, by the terms of said policy, agree that it would pay all sums, not exceeding $100,000.00 for the injury or death of one person or $300,000.00 for the injury or death of more than one person in the same accident, which said North Umberland Mining

Company, or any person using or operating said Lincoln Zephyr automobile with the permission of said North Umberland Mining Company, should become obligated to pay by reason of the liability imposed upon them, or either of them, by law for damages on account of bodily injury or death at any time resulting from or suffered, or alleged to have been suffered, by any person or persons due to any accident as result of the ownership, use, operation or maintenance of said Lincoln Zephyr automobile; and that the said Home Indemnity Company of New York, under the terms of said policy, did further agree that it would, at its own cost and expense, investigate all accidents alleged to have occurred as result of the operation of said Lincoln Zephyr automobile, and would, at its own cost and expense, defend and care for on behalf of each person assured under said policy all [27] suits or actions at law brought as result of any such accident, even if groundless.

XIII.

That on or about the 29th day of September, 1945, plaintiff, Standard Accident Insurance Company of Detroit, issued to the defendant, George White, in the State of California, a certain policy of automobile liability insurance, wherein and whereby it agreed to pay, on behalf of said George White, all sums which he should become obligated to pay by reason of the liability imposed upon him by law for damages because of bodily injury, including death at any time resulting therefrom, sustained by any person or persons, caused by accident arising out

of the ownership, maintenance or use of a certain 1942 Packard five-passenger convertible coupe, not exceeding, however, the sum of $25,000.00 for the bodily injury or death of one person, or $50,000.00 for more than one person injured or killed in one accident.

XIV.

That by the terms of said policy plaintiff, Standard Accident Insurance Company of Detroit, further agreed that if the automobile described in said policy issued by it to the defendant, George White, should be withdrawn from normal use because of its breakdown, repair, servicing, loss or destruction, the insurance afforded by said policy with respect to the automobile described therein should apply with respect to any other automobile not owned by said George White while temporarily used as a substitute for the automobile described in said policy, but that by the terms of said policy it was further provided that such insurance as to the use of said substituted automobile should be excess insurance over any other valid and collectible insurance available to said George White under a policy applicable with respect to the substituted automobile or otherwise against loss covered by either [28] or both of said insuring agreements; that a photostatic copy of said policy is annexed to the complaint of Standard Accident Insurance Company of Detroit.

XV.

That the Packard automobile described in paragraph XIII hereof and described in the policy of

insurance issued by plaintiff, Standard Accident Insurance Company of Detroit, to said George White was withdrawn from normal use because of breakdown or repair, and on the 20th day of July, 1946, and while said Packard automobile was broken down and under repair, defendant, George White, was driving the aforesaid Lincoln Zephyr automobile, the property of Intervener, North Umberland Mining Company, in the County of San Diego, State of California, with the consent of said North Umberland Mining Company, and did then run into and collide with one Claude McLester Lee and one Leana Mae Osborne Lee, and as a result of the injuries sustained in said collision said Claude McLester Lee and said Leana Mae Osborne Lee died.

XVI.

That defendant, George White, in reporting the accident hereinabove referred to gave to defendant, Home Indemnity Company of New York, false, conflicting and misleading statements and reports of said accident, and that said George White thereby breached the conditions of the policy of insurance issued by said Home Indemnity Company of New York, and that by reason of such breach defendant, Home Indemnity Company of New York, was excused from the performance as to George White of its obligations under its policy of insurance issued by it as aforesaid; that said policy of insurance contains conditions material to the assumption by Home Indemnity Company of New York of the risks incident to such insurance, among other things that

the said George White should cooperate with the Company and that said George White should not assume any obligations incident to the happening of any accident insured against; that in violation [29] of said conditions said George White failed, neglected and refused to cooperate with Home Indemnity Company of New York in the matter of the investigation of the facts of said accident and in the handling of claims arising therefrom by giving to said Home Indemnity Company of New York false, misleading and conflicting statements as to the facts of said accident and his connection therewith and by voluntarily entering a plead of guilty to a criminal charge of the violation of the provisions of Section 480 of the Vehicle Code of the State of California in respect to the accident referred to.

That all of the matters and things found by this paragraph occurred after July 20, 1946.

XVII.

The court finds that the rights and liabilities of defendant George White, defendant Home Indemnity Company of New York, and plaintiff Standard Accident Insurance Company of Detroit, became and were fixed not later than the time of the accident above referred to; that at the time of said accident George White had other valid and collectible and available insurance within the meaning of the provisions of the policy issued to him by Standard Accident Insurance Company of New York, namely, the insurance provided for and afforded to him by the policy issued to the intervener, North Umberland Mining Company, by defendant Home Indem-

nity Company of New York; that the subsequent breach of the provisions and conditions of the policy of insurance of Home Indemnity Company of New York by the defendant George White did not alter or change the rights or liabilities of the plaintiff, Standard Accident Insurance Company of Detroit, as the excess carrier; that the insurance afforded by the policy of plaintiff, Standard Accident Insurance Company of Detroit, was and now is solely excess insurance over and above a sum equal to the limits of the insurance afforded to the defendant George White by the policy of Home Indemnity Company of New York, and which latter insurance was [30] valid and collectible and available to George White at the time of said accident.

From the foregoing Findings of Fact the Court draws the following

Conclusions of Law

1. This Court has jurisdiction of the parties and the subject matter of this action.

2. Intervener, North Umberland Mining Company, is entitled to judgment against defendant, George White, in the sum of $8,750.00, together with interest at the rate of seven per cent (7%) per annum from January 19, 1948, together with its costs.

3. Plaintiff, Standard Accident Insurance Company of Detroit, is not obligated to anyone under its policy, the subject of this action.

Done in open Court at Los Angeles, California, this 25th day of January, 1951.

/s/ JAMES M. CARTER,
United States District Judge.

Affidavit of Service by Mail attached.

Lodged January 15, 1951.

[Endorsed]: Filed January 25, 1951. [31]

In the District Court of the United States, Southern District of California, Central Division

No. 5729-C Civil

STANDARD ACCIDENT INSURANCE COMPANY OF DETROIT, a Corporation,
Plaintiff,

vs.

HOME INDEMNITY COMPANY OF NEW YORK, a Corporation, GEORGE WHITE, JAMES CARL FITZGERALD, JAMES RICHARD OSBORNE, MICHAEL LEE and PATRICIA LEE,
Defendants,

NORTH UMBERLAND MINING COMPANY, a Corporation,
Intervener.

JUDGMENT

This action having come on regularly for trial on December 22, 1950, before the above-entitled court,

the Honorable James M. Carter, Judge presiding, upon the complaint in intervention of North Umberland Mining Company, Intervener, and the answer of plaintiff, Standard Accident Insurance Company of Detroit, thereto and the answer of the defendant, George White, thereto, and oral and documentary evidence having been introduced by the respective parties, and the cause having been argued and submitted to the Court for decision and the court having been fully informed and advised in the premises and having made its Findings of Fact and [33] Conclusions of Law,

Now, Therefore, It Is Adjudged and Decreed as Follows:

1. That intervener, North Umberland Mining Company, have judgment against defendant, George White, in the sum of $8750.00 and for the additional sum of $1849.37, which is interest on $8750.00 at the rate of seven per cent (7%) per annum from January 19, 1948, to date, to wit a total judgment of $10,599.37 together with costs taxed in the sum of $.....

2. The Court declares that plaintiff, Standard Accident Insurance Company of Detroit, is not obligated to anyone under the terms of its policy.

3. The action, insofar as it applies to defendants, Fitzgerald, Osborne, Michael Lee, Patricia Lee and Taylor, having become moot, none of said defendants is entitled to any relief.

4. Defendant, Home Indemnity Company of New

York, is not obligated to anyone under the terms of its policy.

5. Plaintiff, Standard Accident Insurance Company of Detroit, and defendant, Home Indemnity Company of New York, are not entitled to costs.

Done in open court at Los Angeles, California, this 25th day of January, 1951.

/s/ JAMES M. CARTER,
United States District Judge.

Affidavit of Service by Mail attached.

Lodged January 15, 1951.

[Endorsed]: Filed January 25, 1951. [34]

[Title of District Court and Cause.]

AFFIDAVIT

State of California,
County of Los Angeles—ss.

Donald Armstrong, being first duly sworn, deposes and says: That at all times herein mentioned he was and now is the Attorney for Intervener North Umberland Mining Company in the above-entitled action; that his client desires to appeal from a judgment entered in said action in so far as said judgment is in favor of Standard Accident Insurance Company of Detroit and against said Intervener.

The time to appeal from said judgment under

rule 73(a) [36] of the rules for United States District Courts has expired unless this Court extends such time pursuant to the provisions of said rule 73(a).

Said Judgment was entered January 25, 1951. Affiant through inadvertence permitted the thirty day period provided for by said rule 73(a) to expire because he was not aware of the entry of said Judgment and did not receive notice of such entry.

Wherefore affiant prays that this Court make its Order extending the time for Intervener North Umberland Mining Company to appeal to March 26, 1951.

Subscribed and sworn to before me this 20th day of March, 1951.

/s/ DONALD ARMSTRONG.

[Seal] /s/ BORIS S. WOOLLEY,
Notary Public in and
For Said County and State.

My commission expires June 15, 1951.

Upon reading the foregoing affidavit, upon application of Donald Armstrong, Attorney for Intervener North Umberland Mining Company, and good cause appearing therefor,

It Is Ordered that said Intervener's time to appeal from the Judgment entered in the above-

entitled cause on January 25, 1951, be and it is hereby extended to March 26, 1951.

Dated: March 20, 1951.

/s/ BENJAMIN HARRISON,
United States District Judge.

[Endorsed]: Filed March 20, 1951. [37]

[Title of District Court and Cause.]

NOTICE OF MOTION AND MOTION FOR ORDER RECONSIDERING EX PARTE ORDER OF MARCH 20, 1951, EXTENDING TIME TO APPEAL AND FOR ORDER VACATING SAME, POINTS AND AUTHORITIES AND AFFIDAVIT OF EVERETT W. THOMPSON IN SUPPORT OF SAID MOTION.

To the Intervener, North Umberland Mining Company, a Corporation, and to Donald Armstrong, Esq., Its Attorney:

You and Each of You Take Notice that the plaintiff, Standard Accident Insurance Company of Detroit, a Corporation, will move the above-entitled court, in Court Room No. 6, on the 23rd day of April, 1951, at the hour of 10:00 o'clock a.m., or as soon thereafter as counsel may be heard, for an order of the above-entitled court reconsidering the ex parte order of March 20, 1951, extending the time to appeal, and for an order [38] vacating the same

and striking said order and affidavit in support thereof from the files and records of the above-entitled action.

Said motion will be made upon the ground that said ex parte order of March 20, 1951, purporting to extend the time within which to appeal in the above-entitled action to March 26, 1951, was made without notice to counsel for said plaintiff or upon motion made in open court, and without an opportunity for counsel for plaintiff to be heard or object thereto, and upon the further ground that the files, records, proceedings and dockets relating to the above-entitled cause affirmatively show that the clerk of the above-entitled court did enter said judgment on January 25, 1951, and did on said date notify all attorneys of the entry of said judgment.

Said motion will be based upon this notice of motion and upon all of the files, records and pleadings in the above-entitled action, and upon the affidavit of Everett W. Thompson served and filed herewith, and upon the Civil Docket of the above-entitled court and all entries therein relating to and pertaining to the above-entitled cause.

Dated: April 6, 1951.

BAUDER, GILBERT,
THOMPSON & KELLY,

By /s/ EVERETT W. THOMPSON,
Attorneys for Plaintiff. [39]

Points and Authorities

I.

It must be presumed that the Clerk, pursuant to his notation, entered in the Civil Docket, notified all attorneys of the entry of the judgment on January 25, 1951, and did forward to each of said attorneys a copy of said notice of entry found in the file in the above-entitled action.

II.

Rule 77(d) of the Federal Rules of Civil Procedure, in part, provides as follows:

> "Lack of notice of the entry by the clerk does not affect the time to appeal or relieve or authorize the court to relieve a party for failure to appeal within the time allowed, except as permitted in Rule 73(a) as amended December 27, 1946, effective March 19, 1948."

III.

Rule 73(a) of the Federal Rules of Civil Procedure, in part, provides as follows:

> "When an appeal is permitted by law from a district court to a court of appeals the time within which an appeal may be taken shall be thirty days from the entry of the judgment appealed from . . . except upon a showing of excusable neglect based on a failure of a party to learn of the entry of the judgment the District Court in any action may extend the time to appeal for not exceeding thirty days from the expiration of the original time herein prescribed." [40]

IV.

In Rules of the United States Court of Appeals for the Ninth Circuit it is stated (see statement preceding Rule 1):

> "The Federal Rules of Civil Procedure, whenever applicable, are hereby adopted as part of the rules of this court with respect to appeals in actions of a civil nature."

V.

Rule 6(b) of Federal Rules of Civil Procedure provides, in part, as follows:

> "When by these rules . . . an act is required or allowed to be done within a specified time, the court for cause shown may at any time in its discretion (1) with or without motion or notice order the period enlarged if request therefor is made before the expiration of the period originally prescribed or as extended by a previous order or (2) upon motion made after the expiration of the specified period permit the act to be done where the failure to act was the result of excusable neglect; but it may not extend the time for taking any action under Rules . . . 73(a) . . . except to the extent and under the conditions stated in them." (Emphasis added.)

[Title of District Court and Cause.]

AFFIDAVIT OF EVERETT W. THOMPSON

State of California,
County of Los Angeles—ss.

Everett W. Thompson, being first duly sworn, deposes and says:

That he is an attorney at law duly licensed to practice in all of the courts of the State of California, and in the above-entitled court; that he is one of the attorneys of record for the plaintiff in the above-entitled action and the attorney who has been and is in charge of the handling of the above-entitled action on behalf of the plaintiff. [42]

That the first notice affiant had that intervener intended to appeal from the judgment in favor of the plaintiff and against said intervener, and entered in the above-entitled cause on January 25, 1951, was receipt by mail on March 23, 1951, of a purported Notice of Appeal, containing an affidavit of service upon affiant's office alleging that said Notice of Appeal was served on March 22, 1951. That neither affiant nor affiant's office was notified in writing prior thereto, and particularly on or about March 20, 1951, that counsel for intervener would attempt to secure an extension of time to appeal from the judgment entered against said intervener and in favor of said plaintiff, and no motion or notice of motion was ever served upon affiant or affiant's office notifying the attorneys of record for plaintiff that counsel for intervener

would seek or attempt to secure an extension of time within which to appeal beyond the thirty day period prescribed by the Federal Rules of Civil Procedure, and no copy of any affidavit filed in support of any order purporting to extend the time to appeal, or said order, or either of them, was ever served upon affiant or affiant's office at ny time. That affiant is the attorney in the office of the attorneys of record for plaintiff who has had charge of the above-entitled action, and particularly the trial of the intervention action on or about December 22, 1950.

That affiant has been engaged in the trial of civil matters in the Superior Court of the State of California practically continuously since March 23, 1951. That affiant has recently inspected the Civil Docket in the above-entitled action and said civil docket does state that attorneys were notified of the entry of the judgment on January 25, 1951. That affiant did receive from the clerk of the above-entitled court on January 26, 1951, a copy of the Notice of Entry of Judgment which is attached hereto, marked "Exhibit A" and made a part hereof with the same force and effect as if fully set out herein, and that the file in the above-entitled [43] action does contain a copy or duplicate of said notice which is attached hereto and marked "Exhibit A." That affiant is informed and believes and alleges that said notice was sent to all attorneys of record in the above-entitled action, as indicated by the entry of the clerk in said civil docket.

That the affidavit filed in support of the order

purporting to extend the time on appeal states no facts by which it could be concluded that there was any inadvertence or excusable neglect other than "because he (counsel for intervener) was not aware of the entry of said judgment and did not receive notice of such entry."

Wherefore, affiant prays that an order of the above-entitled court be made and entered vacating and setting aside the ex parte order of March 20, 1951, purporting to extend the time to appeal in the above-entitled action and to strike said order and affidavit in support thereof from the files and records of the above-entitled court.

/s/ EVERETT W. THOMPSON.

Subscribed and sworn to before me this 6th day of April, 1951.

[Seal] /s/ ROSE SCHINDELMAN,
Notary Public in and for
Said County and State. [44]

EXHIBIT A

United States District Court, Southern District of California, Central Division

Bauder, Gilbert, Thompson & Kelly, Esqs., 639 Rowan Bldg., Los Angeles 13, Calif.

Donald Armstrong, Esq., 1308 Sartori, Ave., Torrance, Calif.

Menzies & Watt, Esqs., 1017 Rowan Bldg., Los Angeles 13, Calif.

Guthrie, Lonergan & Jordan, Esqs., 506 Anderson Bldg., San Bernardino, Calif.

Edgar B. Hervey, Esq., San Diego Trust & Savings Bldg., San Diego 1, Calif.

Luce, Forward, Lee & Kunzel, Esqs., 1220 San Diego Trust & Savings Bldg., San Diego 1, Calif.

Re: Standard Accident Insurance Co. of Detroit, vs. Home Indemnity Company of New York, et al., No. 5729-C

You are hereby notified that judgment has been entered this day in the above-entitled case, in Judgment Book No. 70, page 470.

Dated: Los Angeles, California,

January 25, 1951.

EDMUND L. SMITH,
Clerk,

By C. A. SIMMONS,
Deputy Clerk.

Affidavit of Service by Mail attached.

[Endorsed]: Filed April 6, 1951. [45]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Intervener, North Umberland Mining Company, does hereby appeal to the United States Court of Appeals for the Ninth Circuit from the Judgment given and made in the above-entitled action in favor of plaintiff therein and against Intervener, North Umberland Mining Company, and entered on the 25th day of January, 1951, and from the whole and every part of said Judgment.

Dated: March 22, 1951.

/s/ DONALD ARMSTRONG,
Attorney for Intervener, North Umberland Mining Company.

Affidavit of Service by Mail attached.

[Endorsed]: Filed March 23, 1951. [51]

At a stated term, to wit: The February Term, A.D. 1951, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Monday the 23rd day of April in the year of our Lord one thousand nine hundred and fifty-one.

Present: The Honorable James M. Carter,
District Judge.

[Title of Cause.]

MINUTE ORDER

For hearing motion of plaintiff, filed April 6, 1951, to vacate the ex parte order of March 20, 1951, extending time to appeal; Jean Wunderlich, Esq., appearing as counsel for plaintiff; Donald Armstrong, Esq., appearing as counsel for intervening plaintiff North Umberland Mining Co.; no appearance for defendants;

Attorney Wunderlich argues in support of the motion. Attorney Armstrong argues in opposition.

The Court declines to rule on the motion and orders it off calendar on the ground that if the order extending time was a voidable order, the taking of the appeal has robbed the District Court of jurisdiction; and if, on the other hand, it is a void order, it is void without this Court acting thereon. [65]

OPINION

The Opinion of the U. S. Court of Appeals for the Ninth Circuit in Cause No. 11661, Home Indemnity Co. of New York vs. Standard Accident Insurance Co. of Detroit, et al. is set forth at 167 F. (2d) 918, and is not reprinted here for purpose of economy.

In the United States District Court, Southern District of California, Central Division

No. 5729-C—Civil

STANDARD ACCIDENT INSURANCE COMPANY OF DETROIT, a Corporation,

Plaintiff,

vs.

HOME INDEMNITY COMPANY OF NEW YORK, a Corporation, et al.,

Defendants.

Honorable James M. Carter, Judge Presiding

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Friday, December 22, 1950

Appearances:

For the Plaintiff:

BAUDER, GILBERT, THOMPSON & KELLY, by

E. W. THOMPSON, ESQ.,
939 Rowan Building,
Los Angeles 13, California.

For the Intervener, North Umberland Mining Company:

DONALD ARMSTRONG, ESQ.,
1308 Sartori Avenue,
Torrance, California.

For the Defendant, George White:
LUCE, FORWARD, LEE & KUNZEL, by
EDGAR LUCE, JR., ESQ.

Mr. Armstrong: May it please the court, if I may say so, I think we could shorten this proceeding materially. We don't propose to offer any additional evidence that is not already before the court, and we intend to stipulate as to supplemental facts.

The Court: What evidence is before me? A transcript of what occurred before O'Connor?

Mr. Armstrong: I don't think it is necessary to have that entire transcript before you. As a matter of fact, I have just been talking to Mr. Thompson, and I think that as far as the case of the intervener is concerned, we are willing to stipulate that the facts recited in the opinion filed by the United States Court of Appeals for the Ninth Circuit [2*] is sufficient for this purpose, with the supplemental stipulation that the judgments in the San Diego proceedings were entered and satisfied, and in a moment we will refer to them with more particularity.

Isn't that about all we will need, Mr. Thompson?

Mr. Thompson: I think that is substantially correct. I discussed this matter at length this morning with Mr. Armstrong. I think this stipulation will eliminate the necessity of any oral testimony and the introduction of any documentary evidence, except two exhibits which we will refer to in a moment, and it is stipulated that judgments were

***Page numbering appearing at foot of page of original Reporter's Transcript of Record.**

entered as pleaded in the complaint in intervention, that those judgments were satisfied. It is, of course, also stipulated that those judgments were entered pursuant to a stipulated judgment, without the consent or any stipulation on behalf of the Standard.

The Court: Who stipulated to those judgments?

Mr. Thompson: Judgments were stipulated to by counsel representing the North Umberland Mining Company and counsel in San Diego representing White.

The Court: And the plaintiff's attorney?

Mr. Armstrong: And the plaintiffs in the respective actions.

Mr. Thompson: The plaintiff in the respective actions; not the plaintiff Standard in this action. [3]

The Court: So counsel for the Standard Accident or the Home Indemnity, neither one stipulated to those judgments?

Mr. Thompson: Counsel for the Standard Accident was not present, did not agree to and did not stipulate to those judgments.

The Court: That is agreed to, is it?

Mr. Armstrong: Yes, your Honor. But the judgments were satisfied by North Umberland, and no payment of any sort was made by the defendant White at that time or any other time.

The Court: From reading the file, this current file, there seemed to be some little question about who paid the judgment. The judgment was paid by the North Umberland Mining Company?

Mr. Armstrong: That's right; and they were defendants in the two San Diego actions.

The Court: That is agreed, is it?

Mr. Thompson: As far as a matter of record is concerned, North Umberland Company being the named insured under the Home policy, it paid the judgment on behalf of the North Umberland, so it is for the benefit of them.

The Court: The true facts are that the Home stood the bill, but it was actually paid for and on behalf of and in substance by the North Umberland Mining Company?

Mr. Thompson: That's right. [4]

The Court: Then there is no dispute about that?

Mr. Armstrong: If you will pardon me——

Mr. Thompson: It is a question of construction, we are both agreed.

Mr. Armstrong: I would like to have the stipulation in the record a little more clearly than it is at the present time, and I would like to in that behalf ask Mr. Thompson, in addition to the stipulation that he has made, to stipulate that the actions that were referred to in which the judgments were entered and satisfied were the judgments alleged in paragraphs VIII and IX, and paragraph XI of the complaint in intervention.

The Court: Of the North Umberland Mining Company?

Mr. Armstrong: That is correct.

Mr. Thompson: There is no doubt about that.

Mr. Armstrong: I want to be sure there will be no misunderstanding about what judgments and what actions we are referring to.

And the policies that we refer to are the Standard

Accident policy, which is attached to plaintiff's complaint and marked Exhibit A in this action, that is to say, the declaratory relief action, and the policy that it attached to the answer of Home Indemnity Company in the declaratory relief action.

Mr. Thompson: Yes. [5]

The Court: It is stipulated those are the policies?

Mr. Thompson: Those are the two policies, and it is agreed they may be marked Exhibits by way of reference in this proceeding, each of said policies of insurance.

Mr. Armstrong: So stipulated.

The Court: Now we are all agreed that those are the facts?

Mr. Armstrong: Correct, your Honor.

Now, I think we can go further than that to save time. I think we can narrow the issues and confine the argument to that narrow issue, that is, that the liability and rights of the parties in this proceeding are to be determined by the construction to be placed by the court on paragraphs VII and VIII of the Standard policy, together with condition 13 of that policy.

Mr. Thompson: Upon the entire terminology of the policy with particular reference to those paragraphs.

Mr. Armstrong: Of course.

Mr. Thompson: Those are the pertinent sections.

The Court: Those are the pertinent sections, but actually it will be a matter of construction of the whole policy.

Mr. Thompson: That's right.

Mr. Armstrong: Yes. And in deciding that question it will be necessary to also construe certain provisions of the Home Indemnity policy, and I will refer to them. [6]

The Clerk: Is there more than one answer of the Home Indemnity in this case?

Mr. Armstrong: There is only one answer of the Home Indemnity.

The Clerk: I don't see that policy that you referred to as being attached.

Mr. Armstrong: On the record on appeal, that is the one I have, the answer of Home Indemnity——

Mr. Thompson: It is Exhibit A to the answer of Home Indemnity Company.

The Clerk: Maybe it was taken out of the file. Do you have a copy of it, your Honor?

The Court: I don't have a copy with me. It may be back in the file somewhere. But I don't have the Circuit Court transcript.

Mr. Thompson: I have a photostatic copy of each. It might be easier to mark it here for that purpose.

The Court: Let's do that.

The Clerk: Intervener's Exhibits 1 and 2?

Mr. Armstrong: Yes.

The Court: The Standard Accident policy will be Intervener's Exhibit 1, and the Home Indemnity policy will be Intervener's Exhibit 2.

(The documents referred to were marked Intervener's Exhibits 1 and 2, respectively, and were received in evidence.) [7]

EXHIBIT A

INTERVENER'S EXHIBIT NO. 1

Automobile Bodily Injury Liability Policy

No. J 427867

Standard
Accident Insurance Company
DETROIT, MICHIGAN
A Stock Company

DECLARATIONS

I NAME AND ADDRESS OF INSURED X2

WHITE GEORGE
9510 WILSHIRE BLVD
BEVERLY HILLS CALIF

POLICY PERIOD FROM SEPTEMBER 29TH 1945 TO SEPTEMBER 29TH 1946

12:01 A. M. STANDARD TIME AT THE ADDRESS OF THE NAMED INSURED AS STATED HEREIN
THE AUTOMOBILE WILL BE PRINCIPALLY GARAGED IN THE ABOVE TOWN, COUNTY AND STATE UNLESS OTHERWISE SPECIFIED HEREIN

THE OCCUPATION OF THE NAMED INSURED IS PRODUCER — INDIVIDUAL [X] COPARTNERSHIP [ ] CORPORATION [ ] ESTATE [ ]

II NO INSURER HAS CANCELLED ANY AUTOMOBILE INSURANCE ISSUED TO THE NAMED INSURED, DURING THE PAST YEAR, EXCEPT AS HEREIN STATED: NO EXCEPTIONS

III THE PURPOSES FOR WHICH THE AUTOMOBILE IS TO BE USED ARE [X] PLEASURE AND BUSINESS [ ] COMMERCIAL

IV DESCRIPTION OF THE AUTOMOBILE:

YEAR & MODEL	TRADE NAME OF AUTOMOBILE	TYPE OF BODY	MOTOR NUMBER	SERIAL NUMBER
1942 2121 1599	PACKARD	5 PS CONV CPE	E- 355618	1599- 2312

NEW OR USED	DATE PURCHASED MONTH	YEAR	COST TO INSURED	V EXCEPT WITH RESPECT TO BAILMENT LEASE, CONDITIONAL SALE, MORTGAGE OR OTHER ENCUMBRANCE THE NAMED INSURED IS THE SOLE OWNER OF THE AUTOMOBILE EXCEPT AS HEREIN STATED
NEW	OCT	1941	1600	NO EXCEPTIONS

VI THE INSURANCE AFFORDED IS ONLY WITH RESPECT TO SUCH AND SO MANY OF THE FOLLOWING COVERAGES AS ARE INDICATED BY SPECIFIC PREMIUM CHARGE OR CHARGES. THE LIMIT OF THE COMPANY'S LIABILITY AGAINST EACH SUCH COVERAGE SHALL BE AS STATED HEREIN, SUBJECT TO ALL OF THE TERMS OF THE POLICY HAVING REFERENCE THERETO.

COVERAGES	LIMITS OF LIABILITY				POLICY NO.	PREMIUMS
(A) BODILY INJURY LIABILITY	$25 000	EACH PERSON	$50 000	EACH ACCIDENT	J-427867	$ 14 42
(B) MEDICAL PAYMENTS	2000	EACH PERSON (NAMED INSURED EXCLUDED)				7 30

COUNTERSIGNED AT LOS ANGELES, CALIFORNIA, BY Louis Bass
AUTHORIZED AGENT

Not valid unless countersigned by a duly authorized Agent of the Company.

Read your policy.

Form Auto 29 Ed. Oct., 1944 (C.A.) (Page 1)

Exhibit A - Page 1

Automobile Bodily Injury Liability Policy

Standard Accident Insurance Company

DETROIT, MICHIGAN

(A STOCK INSURANCE COMPANY, HEREIN CALLED THE COMPANY)

Agrees with the insured, named in the declarations made a part hereof, in consideration of the payment of the premium and in reliance upon the statements in the declarations and subject to the limits of liability, exclusions, conditions and other terms of this policy:

INSURING AGREEMENTS

I **Coverage A—Bodily Injury Liability** . . . . . To pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages, including damages for care and loss of services, because of bodily injury, including death at any time resulting therefrom, sustained by any person or persons, caused by accident and arising out of the ownership, maintenance or use of the automobile.

Coverage C—Medical Payments . . . . . To pay to or for each person who sustains bodily injury, caused by accident, while in or upon, entering or alighting from (1) the automobile classified as "pleasure and business" if the injury arises out of the use thereof by or with the permission of the named insured, or (2) any other private passenger automobile with respect to the use of which insurance is afforded under Insuring Agreement VII of this policy, if the injury arises out of the use thereof and results from (a) the operation of said automobile by the named insured or spouse or by a private chauffeur or domestic servant of either or (b) the occupancy of said automobile by the named insured or spouse, the reasonable expense of necessary medical, surgical, ambulance, hospital and professional nursing services and, in the event of death resulting from such injury, the reasonable funeral expense, all incurred within one year from the date of accident.

The insurance afforded with respect to such other automobiles shall be excess insurance over any other valid and collectible medical payments insurance applicable thereto.

II **Defense, Settlement, Supplementary Payments** . . . . . As respects such insurance as is afforded by the other terms of this policy under coverage A the company shall

(a) defend in his name and behalf any suit against the insured alleging such injury or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the company shall have the right to make such investigation, negotiation and settlement of any claim or suit as may be deemed expedient by the company;

(b) pay all premiums on bonds to release attachments for an amount not in excess of the applicable limit of liability of this policy, all premiums on appeal bonds required in any such defended suit, but without any obligation to apply for or furnish such bonds, all costs taxed against the insured in any such suit, all expenses incurred by the company, all interest accruing after entry of judgment until the company has paid, tendered or deposited in court such part of such judgment as does not exceed the limit of the company's liability thereon, and expenses incurred by the insured, in the event of bodily injury, for such immediate medical and surgical relief to others as shall be imperative at the time of accident;

(c) reimburse the insured for all reasonable expenses, other than loss of earnings, incurred at the company's request.

The company agrees to pay the amounts incurred under this insuring agreement, except settlements of claims and suits, in addition to the applicable limit of liability of this policy.

III **Bail Bond Expense** . . . . . The company shall pay the cost of bonds, but without obligation to apply for or furnish such bonds, guaranteeing the insured's appearance in court if such appearance is required by reason of an accident or a traffic law violation occurring during the policy period and arising out of the use of an automobile with respect to which use insurance is afforded such insured under coverage A of this policy. The company's liability under this insuring agreement with respect to each bond shall not exceed the usual charges of surety companies for such bond nor $100.

IV **Definition of "Insured"** . . . . . The unqualified word "insured" wherever used in coverage A and in other parts of this policy, when applicable to such coverage, includes the named insured and, except where specifically stated to the contrary, also includes any person while using the automobile and any person or organization legally responsible for the use thereof, provided the actual use of the automobile is with the permission of the named insured. The insurance with respect to any person or organization other than the named insured does not apply:

(a) to injury to or death of any person who is a named insured;

(b) with respect to the automobile while used with any trailer not covered by like insurance in the company; or with respect to any trailer covered by this policy while used with any automobile not covered by like insurance in the company;

(c) to any person or organization, or to any agent or employee thereof, operating an automobile repair shop, public garage, sales agency, service station or public parking place, with respect to any accident arising out of the operation thereof;

(d) to any employee with respect to injury to or death of another employee of the same employer injured in the course of such employment in an accident arising out of the maintenance or use of the automobile in the business of such employer.

V **Automobile Defined, Trailers, Two or More Automobiles** . . . . . Except where specifically stated to the contrary, the word "automobile" wherever used in this policy shall mean the motor vehicle, trailer or semitrailer described in this policy. The word "trailer" shall include semitrailer.

Such insurance as is afforded by this policy for bodily injury liability with respect to a private passenger automobile applies also to a trailer not described in this policy while used with such automobile, if such trailer is designed for use with a private passenger automobile and is not a home, cabin, office, store, product or process display, demonstration or passenger trailer. While not used with such automobile, such insurance applies also to such trailer but only with respect to the named insured and does not apply to the use of the trailer in his business occupation or with an automobile of the commercial or truck type owned or used by him.

When two or more automobiles are insured hereunder, the terms of this policy shall apply separately to each but a motor vehicle and a trailer or trailers attached thereto shall be held to be one automobile as respects limits of liability under coverage A.

VI **Purposes of Use Defined** . . . . . (a) The term "pleasure and business" is defined as personal, pleasure, family and business use. (b) The term "commercial" is defined as use principally in the business occupation of the named insured as stated in item 1 of the declarations, including occasional use for personal, pleasure, family and other business purposes. (c) Use of the automobile for the purposes stated includes the loading and unloading thereof.

VII **Use of Other Automobiles** . . . . . Such insurance as is afforded by this policy for bodily injury liability with respect to the automobile classified as "pleasure and business" applies (1) to the named insured, if an individual and the owner of such automobile, or if husband and wife either or both of whom own such automobile, and (2) to the spouse of such individual if a resident of the same household, to the employer of such named insured or spouse and to the parent or guardian of such named insured or spouse, if a minor, as insured, with respect to the use of any other automobile by or in behalf of such named insured or spouse.

This insuring agreement does not apply:

(a) to any automobile owned in full or in part by, registered in the name of, hired as part of a frequent use of hired automobiles by, or furnished for regular use to, the named insured or a member of his household other than a private chauffeur or domestic servant of the named insured or spouse;

(b) with respect to such employer, parent or guardian, to any automobile owned in full or in part by him or registered in his name or hired by him as part of a frequent use of hired automobiles;

(c) to any automobile not of the private passenger type while used in the business or occupation of the named insured or spouse, or to any private passenger automobile while used in such business or occupation if operated by a person other than the named insured or spouse or such chauffeur or servant unless the named insured or spouse is present in such automobile;

(d) to any insured other than as defined in this insuring agreement;

(e) to injury to or death of any person who is a named insured;

(f) to any accident arising out of the operation of an automobile repair shop, public garage, sales agency, service station or public parking place.

VIII **Temporary Use of Substitute Automobile** . . . . . While an automobile owned in full or in part by the named insured is withdrawn from normal use because of its breakdown, repair, servicing, loss or destruction, such insurance as is afforded by this policy with respect to such automobile applies with respect to another automobile not so owned while temporarily used as the substitute for such automobile. This insuring agreement does not cover as an insured the owner of the substitute automobile or any employee of such owner.

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IX **Automatic Insurance for Newly Acquired Automobiles** . . . . . If the named insured who is the owner of the automobile acquires ownership of another automobile and so notifies the company within thirty days following the date of its delivery to him, such insurance as is afforded by this policy applies also to such other automobile as of such delivery date:

(a) if it replaces an automobile described in this policy, but only to the extent the insurance is applicable to the replaced automobile, or

(b) if it is an additional automobile and if the company insures all automobiles owned by the named insured at such delivery date, but only to the extent the insurance is applicable to all such previously owned automobiles.

This insuring agreement does not apply: (a) to any loss against which the named insured has other valid and collectible insurance, or (b) except during the policy period, but if such delivery date is prior to the effective date of this policy, the insurance applies as of such effective date.

The named insured shall pay any additional premium required because of the application of the insurance to such other automobile. The insurance terminates upon the replaced automobile on such delivery date.

X **Policy Period, Territory, Purposes of Use** . . . . . This policy applies only to accidents which occur during the policy period, while the automobile is within the United States of America, its territories or possessions, Canada or Newfoundland, or is being transported between ports thereof, and is owned, maintained and used for the purposes stated as applicable thereto in the declarations.

EXCLUSIONS

This policy does not apply:

(a) under any of the coverages, while the automobile is used as a public or livery conveyance, unless such use is specifically declared and described in this policy and premium charged therefor;
(b) under any of the coverages, to liability assumed by the insured under any contract or agreement;
(c) under coverage A, while the automobile is used for the towing of any trailer owned or hired by the named insured and not covered by like insurance in the company; or while any trailer covered by this policy is used with any automobile owned or hired by the named insured and not covered by like insurance in the company;
(d) under coverages A and C, to bodily injury to or death of any employee of the insured while engaged in the employment, other than domestic, of the insured, or while engaged in the operation, maintenance or repair of the automobile;
(e) under coverage A, to any obligation for which the insured or any company as his insurer may be held liable under any workmen's compensation law;
(f) under coverage C, to bodily injury to or death of (1) any person to or for whom benefits are payable under any workmen's compensation law because of such injury or death, or (2) the named insured if stated as excluded in the declarations, but if the named insured is two or more individuals, the named insured, for the purposes of this exclusion, shall be the individual or individuals in whose name the automobile is registered.

CONDITIONS

Conditions 1, 2, 4, 5, 7, 8, 9, 10, 11, 12, 13 and 14 apply only to the coverage or coverages noted thereunder.

1 **Limits of Liability—Coverage A** . . . . . The limit of bodily injury liability stated in the declarations as applicable to "each person" is the limit of the company's liability for all damages, including damages for care and loss of services, arising out of bodily injury, including death at any time resulting therefrom, sustained by one person in any one accident; the limit of such liability stated in the declarations as applicable to "each accident" is, subject to the above provision respecting each person, the total limit of the company's liability for all damages, including damages for care and loss of services, arising out of bodily injury, including death at any time resulting therefrom, sustained by two or more persons in any one accident.

2 **Limit of Liability—Coverage C** . . . . . The limit of liability for medical payments stated in the declarations as applicable to "each person" is the limit of the company's liability for all expenses incurred by or on behalf of each person who sustains bodily injury, including death resulting therefrom, in any one accident.

3 **Limits of Liability** . . . . . The inclusion herein of more than one insured shall not operate to increase the limits of the company's liability.

4 **Financial Responsibility Laws—Coverage A** . . . . . Such insurance as is afforded by this policy for bodily injury liability shall comply with the provisions of the motor vehicle financial responsibility law of any state or province which shall be applicable with respect to any such liability arising out of the ownership, maintenance or use of the automobile during the policy period, to the extent of the coverage and limits of liability required by such law, but in no event in excess of the limits of liability stated in this policy. The insured agrees to reimburse the company for any payment made by the company which it would not have been obligated to make under the terms of this policy except for the agreement contained in this paragraph.

5 **Assault and Battery—Coverage A** . . . . . Assault and battery shall be deemed an accident unless committed by or at the direction of the insured.

6 **Notice of Accident** . . . . . When an accident occurs written notice shall be given by or on behalf of the insured to the company or any of its authorized agents as soon as practicable. Such notice shall contain particulars sufficient to identify the insured and also reasonably obtainable information respecting the time, place and circumstances of the accident, the names and addresses of the injured and of available witnesses.

7 **Notice of Claim or Suit—Coverage A** . . . . . If claim is made or suit is brought against the insured, the insured shall immediately forward to the company every demand, notice, summons or other process received by him or his representative.

8 **Assistance and Cooperation of the Insured—Coverage A** . . . . . The insured shall cooperate with the company and, upon the company's request, shall attend hearings and trials and shall assist in effecting settlements, securing and giving evidence, obtaining the attendance of witnesses and in the conduct of suits. The insured shall not, except at his own cost, voluntarily make any payment, assume any obligation or incur any expense other than for such immediate medical and surgical relief to others as shall be imperative at the time of accident.

9 **Medical and Other Reports; Examination—Coverage C** . . . . . The injured person or someone on his behalf shall, as soon as practicable after each request from the company, furnish reasonably obtainable information pertaining to the accident and injury, and execute authorization to enable the company to obtain medical reports and copies of records. The injured person shall submit to physical examination by physicians selected by the company when and as often as the company may reasonably require.

10 **Proof and Payment of Claim—Coverage C** . . . . . As soon as practicable after completion of the services or after the rendering of services which in cost equal or exceed the limit of liability for medical payments or after the expiration of one year from the date of the accident, whichever is the first, the injured person or someone on his behalf shall give to the company written proof of claim under oath, stating the name and address of each person and organization which has rendered services, the nature and extent and the dates of rendition of such services, the itemized charges therefor and the amounts paid thereon. Upon the company's request, the injured person or someone on his behalf shall cause to be given to the company by each such person and organization written proof of claim under oath, stating the nature and extent and dates of rendition of such services, the itemized charges therefor and the payments received thereon.
The company shall have the right to make payment at any time to the injured person or to any such person or organization on account of the services rendered, and a payment so made shall reduce to the extent thereof the amount payable hereunder or for such injured person on account of such injury. Payment hereunder shall not constitute admission of liability of the insured or, except hereunder, of the company.

11 **Action Against Company—Coverage A** . . . . . No action shall lie against the company unless, as a condition precedent thereto, the insured shall have fully complied with all the terms of this policy, nor until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company.
Any person or organization or the legal representative thereof who has secured such judgment or written agreement shall thereafter be entitled to recover under this policy to the extent of the insurance afforded by this policy. Nothing contained in this policy shall give any person or organization any right to join the company as a co-defendant in any action against the insured to determine the insured's liability.
Bankruptcy or insolvency of the insured or of the insured's estate shall not relieve the company of any of its obligations hereunder.

12 **Action Against Company—Coverage C** . . . . . No action shall lie against the company unless, as a condition precedent thereto, there shall have been full compliance with all the terms of this policy, nor until thirty days after the required proofs of claim have been filed with the company.

13 **Other Insurance—Coverage A** . . . . . If the insured has other insurance against a loss covered by this policy the company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the declarations bears to the total applicable limit of liability of all valid and collectible insurance against such loss; provided, however, the insurance under Insuring Agreements VII and (VIII) shall be excess insurance over any other valid and collectible insurance available to the insured, either as an insured under a policy applicable with respect to the automobile or otherwise, against a loss covered under either or both of said insuring agreements.

Exhibit 2-page 3

14 **Subrogation—Coverage A** . . . . . In the event of any payment under this policy, the company shall be subrogated to all the insured's rights of recovery therefor against any person or organization and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing after loss to prejudice such rights.

15 **Changes** . . . . . Notice to any agent or knowledge possessed by any agent or by any other person shall not effect a waiver or a change in any part of this policy or estop the company from asserting any right under the terms of this policy, nor shall the terms of this policy be waived or changed, except by endorsement issued to form a part of this policy, signed by the president, a vice president, or the secretary of the company.

16 **Assignment** . . . . . Assignment of interest under this policy shall not bind the company until its consent is endorsed hereon; if, however, the named insured shall die or be adjudged bankrupt or insolvent within the policy period, this policy, unless canceled, shall, if written notice be given to the company within sixty days after the date of such death or adjudication, cover (1) the named insured's legal representative as the named insured, and (2) under coverage A, subject otherwise to the provisions of Insuring Agreement IV, any person having proper temporary custody of the automobile, as an insured, and under coverage C, while the automobile is used by such person, until the appointment and qualification of such legal representative but in no event for a period of more than sixty days after the date of such death or adjudication.

17 **Cancelation** . . . . . This policy may be canceled by the named insured by mailing to the company written notice stating when thereafter such cancelation shall be effective. This policy may be canceled by the company by mailing to the named insured at the address shown in this policy written notice stating when not less than five days thereafter such cancelation shall be effective. The mailing of notice as aforesaid shall be sufficient proof of notice and the effective date and hour of cancelation stated in the notice shall become the end of the policy period. Delivery of such written notice either by the named insured or by the company shall be equivalent to mailing.
If the named insured cancels, earned premiums shall be computed in accordance with the customary short rate table and procedure. If the company cancels, earned premiums shall be computed pro rata. Premium adjustment may be made at the time cancelation is effected and, if not then made, shall be made as soon as practicable after cancelation becomes effective. The company's check or the check of its representative mailed or delivered as aforesaid shall be a sufficient tender of any refund of premium due to the named insured.

18 **Declarations** . . . . . By acceptance of this policy the named insured agrees that the statements in the declarations are his agreements and representations, that this policy is issued in reliance upon the truth of such representations and that this policy embodies all agreements existing between himself and the company or any of its agents relating to this insurance.

In Witness Whereof . . . . . the **STANDARD ACCIDENT INSURANCE COMPANY** has caused this policy to be signed by its president and secretary at Detroit, Michigan, and countersigned on the declarations page by a duly authorized agent of the company.

F. R. Brown
Secretary

Charles C. Bowler
President

MEXICAN COVERAGE ENDORSEMENT

In consideration of the premium for the policy to which this endorsement is attached and of which it forms a part, it is hereby understood and agreed that such insurance as is afforded by the policy is extended to apply while the automobile is being used for trips into the Republic of Mexico, PROVIDED THAT, this endorsement does not apply unless the insured's place of residence is within the United States of America and the automobile insured by the policy is principally garaged, maintained and used within the United States of America.

This endorsement forms a part of the Automobile Bodily Injury Liability Policy to which it is attached.

Standard Accident Insurance Company

F. R. Brown
Secretary

Standard
Accident Insurance Company
DETROIT, MICHIGAN
A STOCK COMPANY

AUTOMOBILE
BODILY INJURY
LIABILITY POLICY

No. J 427867

READ YOUR POLICY

INSURANCE BUREAU
of the
AUTOMOBILE CLUB
OF SOUTHERN CALIFORNIA
PHARMACY AT ADAMS - LOS ANGELES
RALPH REYNOLDS, MANAGER

Admitted December 22, 1950.

INTERVENER'S EXHIBIT NO. 2

(2)

PACIFIC

Policy No. CAU 6011452

Renewal No. CAU 11370153

Combination Automobile Policy

ISSUED BY

Agency at

PAGE ONE

THE HOME INSURANCE COMPANY, NEW YORK

A STOCK COMPANY

— AND —

THE HOME INDEMNITY COMPANY, NEW YORK

A STOCK COMPANY

DECLARATIONS

Item 1 NAME OF INSURED: BEITH, DOHERTY and [illegible] CO., JOINTLY as THEIR RESPECTIVE INTERESTS MAY APPEAR.

ADDRESS: No. 8484 Street, BEVERLY BLVD., Town or City, BEVERLY HILLS, County, CALIFORNIA, State

OCCUPATION of the Named Insured is: PRIVATE CLUB

EMPLOYER

GARAGE: The automobile will be principally garaged in the above town or city, county and state unless otherwise stated herein:

Item 2 POLICY PERIOD: From DECEMBER 2, 1945 to DECEMBER 2, 1946

12:01 A. M., Standard Time at the address of the named insured as stated herein

Item 3 LOSS PAYEE: Any loss under Coverages D, E, E1, F, G, H and I is payable as interest may appear to the named insured and

Name and Address

Item 4 THE INSURANCE AFFORDED is only with respect to such and so many of the following coverages as are indicated by specific premium charge or charges. The limit of the company's liability against each such coverage shall be as stated herein, subject to all the terms of this policy having reference thereto:

SPECIMEN POLICY

COVERAGES	LIMITS OF LIABILITY		Net Rates	PREMIUMS The Home Indemnity Co.	The Home Insurance Co.
A—Bodily Injury Liability	$ 100,000.	each person			
	$ 300,000.	each accident	X X X	$ 23.49	X X X X X
B—Property Damage Liability	$ 5,000.	each accident	X X X	$ 9.50	X X X X X
C—Medical Payments (Named Insured [no.] [Street] Insured "Included" or "excluded")	$	each person	X X X	$	X X X X X
D—Comprehensive—Loss of or damage to the Automobile, except by Collision but including Fire, Theft and Windstorm	$ ACTUAL CASH VALUE (Insert Amount or "Actual Cash Value")			$	$ 7.00
E—Collision or Upset	Actual Cash Value Less $ 1	Deductible	X X X	X X X X X	$
E1—Convertible Collision or Upset Additional Payment $	Actual Cash Value		X X X	X X X X X	$
F—Fire, Lightning and Transportation	$ ACTUAL CASH VALUE			X X X X X	$ INCL.
G—Theft (Broad Form)	$			X X X X X	$ INCL.
H—Combined Additional Coverage	$			X X X X X	$
I—Personal Effects (Fire, Lightning and Transportation Coverage Only)	$			X X X X X	$
80% Co-Insurance Endorsement attached	$			$	$ 62.00
LIAB. AMENDMENT FORM H-6849		TOTAL PREMIUM		$ 32.79	$ 69.00
LTD. MEX. END. #3223 CLASS I		GRAND TOTAL PREMIUM			$ 101.79

Item 5. Description of the automobile and facts respecting its purchase by the named insured:

1. Model 2. Year	Trade Name	Body Type; Truck Load Capacity or Factory Gross Weight; Tank Gallonage Capacity or Bus Seating Capacity	1. Serial Number 2. Motor Number	Number of Cylinders
1. 269 2. 1942	LINCOLN ZEPHYR	FOUR DOOR SEDAN	1 2. 132537	12

F.O.B. Unit Price or Delivered Price at Factory	Actual Cost When Purchased Including Equipment	Purchased Month, Year	New or Used	Encumbrance	The automobile is unencumbered unless otherwise stated herein: Installment Payments Number	Amount of Each	Due date and Amount of Final Installment
$ "I"	$ 2479.00	MAUG. 1943	USED	$ NIL		$	$

Item 6 Use: The purposes for which the automobile is to be used are: BUSINESS & PLEASURE

(a) The term "pleasure and business" is defined as personal, pleasure, family and business use.

(b) The term "commercial" is defined as use principally in the business occupation of the named insured as stated in Item 1, including occasional use for personal, pleasure, family and other business purposes.

(c) Use of the automobile for the purposes stated includes the loading and unloading thereof.

Item 7 (a) Except with respect to bailment lease, conditional sale, mortgage or other encumbrance the named insured is the sole owner of the automobile. (b) During the past year no insurer has cancelled any automobile insurance issued to the named insured

NO EXCEPTIONS

Exception if any, to (a) or (b)

Date and Place of Issue 11-30-45, NORTH HOLLYWOOD, CALIFORNIA

Countersigned by CHESTER DE YOUNG

Agent

EXHIBIT "A"

Standard Accident Insurance, etc., et al. 25

[22]

5-7 ad 9'or L.A.

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THE HOME INSURANCE COMPANY, NEW YORK
AND
THE HOME INDEMNITY COMPANY, NEW YORK

(Each a Stock Insurance Company herein called the Company)

Severally agree with the insured, named in the declarations made a part hereof, in consideration of the payment of the premium and in reliance upon the statements in the declarations and subject to the limits of liability, exclusions, conditions and other terms of this policy, provided that **THE HOME INDEMNITY COMPANY, NEW YORK** shall be the insurer with respect to Coverages A, B and C and no other, and **THE HOME INSURANCE COMPANY, NEW YORK** shall be the insurer with respect to Coverages D, E, E1, F, G, H and I and no other

INSURING AGREEMENTS

I Coverage A—BODILY INJURY LIABILITY

To pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages, including damages for care and loss of services, because of bodily injury, including death at any time resulting therefrom, sustained by any person or persons, caused by accident and arising out of the ownership, maintenance or use of the automobile.

Coverage B—PROPERTY DAMAGE LIABILITY

To pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages because of injury to or destruction of property, including the loss of use thereof, caused by accident and arising out of the ownership, maintenance or use of the automobile.

Coverage C—MEDICAL PAYMENTS

To pay to or for each person who sustains bodily injury, caused by accident and arising out of the use of the automobile classified as "pleasure and business," while in or upon, entering or alighting from the automobile while the automobile is used by or with the permission of the named insured, the reasonable expense of necessary medical, surgical, ambulance, hospital and professional nursing services and, in the event of death resulting from such injury, the reasonable funeral expense, all incurred within one year from the date of accident.

Coverage D—COMPREHENSIVE LOSS OF OR DAMAGE TO THE AUTOMOBILE, EXCEPT BY COLLISION

To pay for any loss of or damage to the automobile, hereinafter called loss, except loss caused by collision of the automobile with another object or by upset of the automobile or by collision of the automobile with a vehicle to which it is attached. Breakage of glass and loss caused by missiles, falling objects, fire, theft, explosion, earthquake, windstorm, hail, water, flood, vandalism, riot or civil commotion shall not be deemed loss caused by collision or upset.

Coverage E—COLLISION OR UPSET

To pay for loss of or damage to the automobile, hereinafter called loss, caused by collision of the automobile with another object or by upset of the automobile, but only for the amount of each such loss in excess of the deductible amount, if any, stated in the declarations as applicable hereto.

Coverage E-1—CONVERTIBLE COLLISION OR UPSET

To pay for loss of or damage to the automobile, hereinafter called loss, caused by collision of the automobile with another object or by upset of the automobile. Upon the occurrence of the first loss for which payment is sought hereunder the insured shall pay to the company the additional payment stated in the declarations. Loss caused by collision or upset occurring prior to the first loss for which payment is sought hereunder is not covered.

Coverage F—FIRE, LIGHTNING AND TRANSPORTATION

To pay for loss of or damage to the automobile, hereinafter called loss, caused (a) by fire or lightning, (b) by smoke or smudge due to a sudden, unusual and faulty operation of any fixed heating equipment serving the premises in which the automobile is located, or (c) by the stranding, sinking, burning, collision or derailment of any conveyance in or upon which the automobile is being transported on land or on water.

Coverage G—THEFT (BROAD FORM)

To pay for loss of or damage to the automobile, hereinafter called loss, caused by theft, larceny, robbery or pilferage.

Coverage H—COMBINED ADDITIONAL COVERAGE

To pay for loss of or damage to the automobile, hereinafter called loss, caused by windstorm, earthquake, explosion, hail, external discharge or leakage of water, flood or rising waters, riot or civil commotion, or the forced landing or falling of any aircraft or of its parts or equipment.

Coverage I—PERSONAL EFFECTS

To pay for loss of or damage caused by fire, lightning or transportation, as defined in this policy, to robes, wearing apparel and other personal effects which are the property of the insured or of any other person in the insured's household, while carried in or upon the automobile.

II. DEFENSE, SETTLEMENT, SUPPLEMENTARY PAYMENTS

As respects such insurance as is afforded by the other terms of this policy

(a) under coverages A and B the company shall

1. defend in his name and behalf any suit against the insured alleging such injury or destruction and seeking damages on account thereof, even if such allegations are groundless, false or fraudulent; but the company shall have the right to make such investigation, negotiation and settlement of any claim or suit as may be deemed expedient by the company;

2. pay all premiums on bonds to release attachments for an amount not in excess of the applicable limit of liability of this policy, all premiums on appeal bonds required in any such defended suit, but without any obligation to apply for or furnish such bonds, all costs taxed against the insured in any such suit, all expenses incurred by the company, all interest accruing after entry of judgment until the company has paid, tendered or deposited in court such part of such judgment as does not exceed the limit of the company's liability thereon, and expenses incurred by the insured, in the event of bodily injury, for such immediate medical and surgical relief to others as shall be imperative at the time of accident;

(b) the company shall reimburse the insured for all reasonable expenses, other than loss of earnings, incurred at the company's request.

The company agrees to pay the amounts incurred under this insuring agreement, except settlements of claims and suits, in addition to the applicable limit of liability of this policy.

III. DEFINITION OF "INSURED"

The unqualified word "insured" wherever used in coverages A and B and in other parts of this policy, when applicable to such coverages, includes the named insured and, except where specifically stated to the contrary, also includes any person while using the automobile and any person or organization legally responsible for the use thereof, provided the actual use of the automobile is with the permission of the named insured. The insurance with respect to any person or organization other than the named insured does not apply:

(a) to injury to or death of any person who is a named insured;

(b) with respect to the automobile while used with any trailer not covered by like insurance in the company, or with respect to any trailer covered by this policy while used with any automobile not covered by like insurance in the company;

(c) to any person or organization, or to any agent or employee thereof, operating an automobile repair shop, public garage, sales agency, service station or public parking place, with respect to any accident arising out of the operation thereof;

(d) to any employee with respect to injury to or death of another employee of the same employer injured in the course of such employment in an accident arising out of the maintenance or use of the automobile in the business of such employer.

IV. AUTOMOBILE DEFINED, TRAILERS, TWO OR MORE AUTOMOBILES

Except where specifically stated to the contrary, the word "automobile" wherever used in this policy shall mean the motor vehicle, trailer or semitrailer described in this policy. The word "trailer" shall include semitrailer.

Such insurance as is afforded by this policy for bodily injury liability and for property damage liability with respect to a private passenger automobile applies also to a trailer not described in this policy while used with such automobile, if such trailer is designed for use with a private passenger automobile and is not used with a store, cabin, office, store, product or process display, demonstration or passenger trailer. While not used with such automobile, such insurance applies also to such trailer but only with respect to the named insured and does not apply to the use of the trailer in his business occupation or with an automobile of the commercial or truck type owned or used by him.

The word "automobile" shall also include under coverages D, E, E1, F, G and H its equipment and other equipment permanently attached thereto.

When two or more automobiles are insured hereunder, the terms of this policy shall apply separately to each but a motor vehicle and a trailer or trailers attached thereto shall be held to be one automobile as respects limits of liability under coverages A and B and separate automobiles as respects limits of liability, including any deductible provisions, under coverages D, E, E1, F, G, H and I.

V USE OF OTHER PRIVATE PASSENGER AUTOMOBILES

Such insurance as is afforded by this policy for bodily injury liability and for property damage liability with respect to the automobile classified as "pleasure and business" applies (1) to the named insured, if an individual and the owner of such automobile or if husband and wife either or both of whom own such automobile, and (2) to the spouse of such individual if a resident of the same household and to the employer of such named insured or spouse, as insured, with respect to the operation of any other private passenger automobile by such named insured or spouse or by a private chauffeur or domestic servant thereof or with respect to the presence of any such person in such other automobile. This insuring agreement does not apply:

(a) to any automobile owned in full or in part by, registered in the name of, hired as part of a frequent use of hired automobiles by, or furnished for regular use to, the named insured or a member of his household other than such chauffeur or servant;

(b) with respect to the employer, to any automobile owned in full or in part by him or registered in his name or hired by him as part of a frequent use of hired automobiles;

(c) to any insured other than as defined in this insuring agreement;

(d) to injury to or death of any person who is a named insured,

(e) to any accident arising out of the operation of an automobile repair shop, public garage, sales agency, service station or public parking place

VI TEMPORARY USE OF SUBSTITUTE AUTOMOBILE

While an automobile owned in full or in part by the named insured is withdrawn from normal use because of its breakdown, repair, servicing, loss or destruction, such insurance as is afforded by this policy for bodily injury liability, for property damage liability and for medical payments with respect to such automobile applies with respect to another automobile not so owned while temporarily used as the substitute for such automobile. This insuring agreement does not cover as an insured the owner of the substitute automobile or any employee of such owner.

VII LOSS OF USE BY THEFT—RENTAL REIMBURSEMENT

The company, following a theft covered under this policy, shall reimburse the named insured for expense not exceeding $5 for any one day nor totaling more than $150 or the actual cash value of the automobile at time of theft, whichever is less, incurred for the rental of a substitute automobile, including taxicabs

[23]

its reimbursement is limited to such expense incurred during the period commencing seventy-two hours after such theft has been reported to the company and the police and terminating, regardless of expiration at the policy period, on the date the whereabouts of the automobile becomes known to the named insured or the company or on such earlier date as the company makes or tenders settlement for such theft.

Such reimbursement shall be made only if the stolen automobile was a private passenger automobile not used as a public or livery conveyance and not owned and held for sale by an automobile dealer.

VIII GENERAL AVERAGE AND SALVAGE CHARGES

The company, with respect to such transportation insurance as is afforded by this policy, shall pay any general average and salvage charges for which the named insured becomes legally liable.

IX. AUTOMATIC INSURANCE FOR NEWLY ACQUIRED AUTOMOBILES

If the named insured who is the owner of the automobile acquires ownership of another automobile and so notifies the company within thirty days following the date of its delivery to him, such insurance as is afforded by this policy applies also to such other automobile as of such delivery date:

(a) if it replaces an automobile described in this policy, but only to the extent the insurance is applicable to the replaced automobile, or

(b) if it is an additional automobile and if the company insures all automobiles owned by the named insured at such delivery date, but only to the extent the insurance is applicable to all such previously owned automobiles;

provided, under coverages D, E, E1, F, G, H and I when a limit of liability is expressed in the declarations as actual cash value, such limit shall apply to such other automobile, and when a limit of liability is so expressed as a stated amount, such limit shall be replaced by the actual cash value of such other automobile, but any deductible amount so expressed shall apply in either case.

This insurance agreement does not apply: (a) to any loss against which the named insured has other valid and collectible insurance, or (b) except during the policy period, but if such delivery date is prior to the effective date of this policy, the insurance applies as at such effective date, or (c) under coverages D, E, E1, F, G, H and I, to automobiles owned and held for sale by automobile dealers.

The named insured shall pay any additional premium required because of the application of the insurance to such other automobile. The insurance terminates upon the replaced automobile on such delivery date.

X POLICY PERIOD, TERRITORY, PURPOSES OF USE

This policy applies only to accidents which occur and to direct and accidental losses to the automobile which are sustained during the policy period, while the automobile is within the United States of America, its territories or possessions, Canada or Newfoundland, or is being transported between ports thereof, and is owned, maintained and used for the purposes stated as applicable thereto in the declarations.

EXCLUSIONS

This policy does not apply:

(a) under any of the coverages, while the automobile is used as a public or livery conveyance, unless such use is specifically declared and described in this policy and premium charged therefor;

(b) under coverages A, B and C, to liability assumed by the insured under any contract or agreement;

(c) under coverages A and B, while the automobile is used for the towing of any trailer owned or hired by the named insured and not covered by like insurance in the company, or while any trailer covered by this policy is used with any automobile owned or hired by the named insured and not covered by like insurance in the company;

(d) under coverages A and C, to bodily injury to or death of any employee of the insured while engaged in the employment, other than domestic, of the insured, or while engaged in the operation, maintenance or repair of the automobile;

(e) under coverage A, to any obligation for which the insured or any company as his insurer may be held liable under any workmen's compensation law;

(f) under coverage B, to injury to or destruction of property owned by, rented to, in charge of or transported by the insured;

(g) under coverage C, to bodily injury to or death of (1) any person to or for whom benefits are payable under any workmen's compensation law because of such injury or death, or (2) the named insured if stated as excluded in the declarations, but if the named insured is two or more individuals, the named insured, for the purposes of this exclusion, shall be the individual or individuals in whose name the automobile is registered,

(h) under coverages D, E, E1, F, G, H and I, while the automobile is subject to any bailment lease, conditional sale, mortgage or other encumbrance not specifically declared and described in this policy;

(i) under coverages D, E, E1, F, G, H and I, to loss due to war, whether or not declared, invasion, civil war, insurrection, rebellion or revolution or to confiscation by duly constituted governmental or civil authority;

(j) under coverages D, E, E1, F, G, H and I, to any damage to the automobile which is due and confined to wear and tear, freezing, mechanical or electrical breakdown or failure, unless such damage is the result of other loss covered by this policy;

(k) under coverages D, E, E1, F, G, H and I, to robes, wearing apparel or personal effects carried in or upon the automobile, unless specifically insured under coverage "I," which coverage shall not apply to salesmen's samples, merchandise for sale or exhibition, theatrical wardrobes, deeds, accounts, bills, moneys, notes, securities or other evidences of debt, nor to property of guests, boarders or employees or property otherwise covered by insurance;

(l) under coverages D, E, E1, F, G, H and I, to tires unless damaged by fire or stolen or unless such loss be coincident with other loss covered by this policy;

(m) under coverages D and G, to loss due to conversion, embezzlement or secretion by any person in lawful possession of the automobile under a bailment lease, conditional sale, mortgage or other encumbrance;

(n) under coverages E and E1, to breakage of glass if insured with respect to such breakage is otherwise afforded;

(o) under coverages E, E1, F, G and I, to loss due to riot or civil commotion;

(p) under coverages D, E, E1, F, G, H and I, while the automobile is used in any illicit trade or transportation.

CONDITIONS

1 NOTICE OF ACCIDENT Coverages A B and C — When an accident occurs written notice shall be given by or on behalf of the insured to the company or any of its authorized agents as soon as practicable. Such notice shall contain particulars sufficient to identify the insured and also reasonably obtainable information respecting the time, place and circumstances of the accident, the names and addresses of the injured and of available witnesses.

2 NOTICE OF CLAIM OR SUIT Coverages A and B — If claim is made or suit is brought against the insured, the insured shall immediately forward to the company every demand, notice, summons or other process received by him or his representative.

3 LIMITS OF LIABILITY Coverage A — The limit of bodily injury liability stated in the declarations as applicable to "each person" is the limit of the company's liability for all damages, including damages for care and loss of services, arising out of bodily injury, including death at any time resulting therefrom, sustained by one person in any one accident, the limit of such liability stated in the declarations as applicable to "each accident" is, subject to the above provision respecting each person, the total limit of the company's liability for all damages, including damages for care and loss of services, arising out of bodily injury, including death at any time resulting therefrom, sustained by two or more persons in any one accident.

4. LIMIT OF LIABILITY Coverage C — The limit of liability for medical payments stated in the declarations as applicable to "each person" is the limit of the company's liability for all expenses incurred by or on behalf of each person who sustains bodily injury, including death resulting therefrom, in any one accident.

5. LIMITS OF LIABILITY Coverages A, B and C — The inclusion herein of more than one insured shall not operate to increase the limits of the company's liability.

6 ACTION AGAINST COMPANY Coverages A and B — No action shall lie against the company unless, as a condition precedent thereto, the insured shall have fully complied with all the terms of this policy, nor until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company.

Any person or organization or the legal representative thereof who has secured such judgment or written agreement shall thereafter be entitled to recover under this policy to the extent of the insurance afforded by this policy. Nothing contained in this policy shall give any person or organization any right to join the company as a co-defendant in any action against the insured to determine the insured's liability. Bankruptcy or insolvency of the insured or of the insured's estate shall not relieve the company of any of its obligations hereunder.

7. ACTION AGAINST COMPANY Coverage C — No action shall lie against the company unless, as a condition precedent thereto, there shall have been full compliance with all the terms of this policy, nor until thirty days after the required proofs of claim have been filed with the company.

8. FINANCIAL RESPONSIBILITY LAWS Coverages A and B — Such insurance as is afforded by this policy for bodily injury liability or property damage liability shall comply with the provisions of the motor vehicle financial responsibility law of any state or province which shall be applicable with respect to any such liability arising out of the ownership, maintenance or use of the automobile during the policy period, to the extent of the coverage and limits of liability required by such law, but in no event in excess of the limits of liability stated in this policy. The insured agrees to reimburse the company for any payment made by the company which it would not have been obligated to make under the terms of this policy except for the agreement contained in this paragraph.

9. ASSAULT AND BATTERY Coverages A and B — Assault and battery shall be deemed an accident unless committed by or at the direction of the insured.

10. MEDICAL AND OTHER REPORTS, EXAMINATION Coverage C — The injured person or someone on his behalf shall, as soon as practicable after each request from the company, furnish reasonably obtainable information pertaining to the accident and injury, and execute authorization to enable the company to obtain medical reports and copies of records. The injured person shall submit to physical examination by physicians selected by the company when and as often as the company may reasonably require.

11. PROOF AND PAYMENT OF CLAIM Coverage C — As soon as practicable after completion of the services or after the rendering of services which in cost equal or exceed the limit of liability for medical payments or after the expiration of one year from the date of the accident, whichever is the first, the injured person or someone on his behalf shall give to the company written proof of claim under oath, stating the name and address of each person and organization which has rendered services, the nature and extent and the dates of rendition of such services, the itemized charges therefor and the amounts paid thereon. Upon the company's request, the injured person or someone on his behalf shall cause to be given to the company by each such person and organization written proof of claim under oath, stating the nature and extent and dates of rendition of such services, the itemized charges therefor and the payments received thereon.

The company shall have the right to make payment at any time to the injured person or to any such person or organization on account of the services rendered, and a payment so made shall reduce to the extent thereof the amount payable hereunder to or for such injured person on account of such injury. Payment hereunder shall not constitute admission of liability of the insured or, except hereunder, of the company.

12 NAMED INSURED'S DUTIES WHEN LOSS OCCURS
Coverages D, E, E1, F, G, H and I

When loss occurs, the named insured shall:
(a) protect the automobile, whether or not the loss is covered by this policy, and any further loss due to the named insured's failure to protect shall not be recoverable under this policy, reasonable expense incurred in affording such protection shall be deemed incurred at the company's request.
(b) give notice thereof as soon as practicable to the company or any of its authorized agents and also, in the event of theft, larceny, robbery or pilferage, to the police but shall not, except at his own cost, offer or pay any reward for recovery of the automobile;
(c) file proof of loss with the company within sixty days after the occurrence of loss, unless such time is extended in writing by the company, in the form of a sworn statement of the named insured setting forth the interest of the named insured and of all others in the property affected, any encumbrances thereon, the actual cash value thereof at time of loss, the amount, place, time and cause of such loss, the amount of rental or other expense for which reimbursement is provided under this policy, together with original receipts therefor, and the description and amounts of all other insurance covering such property.

Upon the company's request, the named insured shall exhibit the damaged property to the company and submit to examinations under oath by anyone designated by the company, subscribe the same and produce for the company's examination all pertinent records and sales invoices, or certified copies if originals be lost, permitting copies thereof to be made, all at such reasonable times and places as the company shall designate.

13 APPRAISAL
Coverages D, E, E1, F, G, H and I

If the named insured and the company fail to agree as to the amount of loss, each shall, on the written demand of either, made within sixty days after receipt of proof of loss by the company, select a competent and disinterested appraiser, and the appraisal shall be made at a reasonable time and place. The appraisers shall first select a competent and disinterested umpire, and failing for fifteen days to agree upon such umpire, then, on the request of the named insured or the company, such umpire shall be selected by a judge of a court of record in the county and state in which such appraisal is pending. The appraisers shall then appraise the loss, stating separately the actual cash value at the time of loss and the amount of loss, and failing to agree shall submit their differences to the umpire. An award in writing of any two shall determine the amount of loss. The named insured and the company shall each pay his or its chosen appraiser and shall bear equally the other expenses of the appraisal and umpire.

The company shall not be held to have waived any of its rights by any act relating to appraisal.

14 LIMIT OF LIABILITY SETTLEMENT OPTIONS NO ABANDONMENT
Coverages D, E, E1, F, G, H and I

The limit of the company's liability for loss shall not exceed the actual cash value of the automobile, or if the loss is of a part thereof the actual cash value of such part, at time of loss nor what it would then cost to repair or replace the automobile or such part thereof with other of like kind and quality, with deduction for depreciation, nor the applicable limit of liability stated in the declarations.

The company may pay for the loss in money or may repair or replace the automobile or such part thereof, as aforesaid, or may return any stolen property with payment for any resultant damage thereto at any time before the loss is paid or the property is so replaced, or may take all or such part of the automobile at the agreed or appraised value but there shall be no abandonment to the company.

15 PAYMENT FOR LOSS, ACTION AGAINST COMPANY
Coverages D, E, E1, F, G, H and I

Payment for loss may not be required nor shall action lie against the company unless, as a condition precedent thereto, the named insured shall have fully complied with all the terms of this policy nor until thirty days after proof of loss is filed and the amount of loss is determined as provided in this policy.

16 NO BENEFIT TO BAILEE
Coverages D, E, E1, F, G, H and I

The insurance afforded by this policy shall not enure directly or indirectly to the benefit of any carrier or bailee liable for loss to the automobile.

17 ASSISTANCE AND COOPERATION OF THE INSURED
Coverages A, B, D, E, E1, F, G, H and I

The insured shall cooperate with the company and, upon the company's request, shall attend hearings and ~~trials and shall assist~~ in effecting settlements, securing and giving evidence, obtaining the attendance of witnesses and in the conduct of suits. The insured shall not, except at his own cost, voluntarily make any payment, assume any obligation or incur any expense other than for such immediate medical and surgical relief to others as shall be imperative at the time of accident.

18 SUBROGATION
Coverages A, B, D, E, E1, F, G, H and I

In the event of any payment under this policy, the company shall be subrogated to all the insured's rights of recovery therefor against any person or organization and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing after loss to prejudice such rights.

19 OTHER INSURANCE
Coverages A, B, D, E, E1, F, G, H and I

If the insured has other insurance against a loss covered by this policy the company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the declarations bears to the total applicable limit of liability of all valid and collectible insurance against such loss, provided, however, the insurance under Insuring Agreements V and VI shall be excess insurance over any other valid and collectible insurance available to the insured, either as an insured under a policy applicable with respect to the automobile or otherwise, against a loss covered under either or both of said insuring agreements.

20 CHANGES Notice to any agent or knowledge possessed by any agent or by any other person shall not effect a waiver or a change in any part of this policy nor estop the company from asserting any right under the terms of this policy; nor shall the terms of this policy be waived or changed, except by endorsement issued to form a part of this policy, signed by the President or Secretary of the company.

21 ASSIGNMENT Assignment of interest under this policy shall not bind the company until its consent is endorsed hereon; if, however, the named insured shall die or be adjudged bankrupt or insolvent within the policy period, this policy, unless canceled, shall, if written notice be given to the company within sixty days after the date of such death or adjudication, cover (1) the named insured's legal representative as the named insured, and (2) under coverages A and B, subject otherwise to the provisions of Insuring Agreement III, any person having proper temporary custody of the automobile, as an insured, and under coverage C while the automobile is used by such person, until the appointment and qualification of such legal representative but in no event for a period of more than sixty days after the date of such death or adjudication.

22 CANCELATION This policy may be canceled by the named insured by surrender thereof or by mailing to the company written notice stating when thereafter such cancelation shall be effective. This policy may be canceled by the company by mailing to the named insured at the address shown in this policy written notice stating when not less than five days thereafter such cancelation shall be effective. The mailing of notice as aforesaid shall be sufficient proof of notice and the effective date and hour of cancelation stated in the notice shall become the end of the policy period. Delivery of such written notice either by the named insured or by the company shall be equivalent to mailing.

If the named insured cancels, earned premiums shall be computed in accordance with the customary short rate table and procedure. If the company cancels, earned premiums shall be computed pro rata. Premium adjustment may be made at the time cancelation is effected and, if not then made, shall be made as soon as practicable after cancelation becomes effective. The company's check or the check of its representative mailed or delivered as aforesaid shall be a sufficient tender of any refund of premium due to the named insured.

23 TERMS OF POLICY CONFORMED TO STATUTE Terms of this policy which are in conflict with the statutes of the State wherein this policy is issued are hereby amended to conform to such statutes.

24 DECLARATIONS By acceptance of this policy the named insured agrees that the statements in the declarations are his agreements and representations, that this policy is issued in reliance upon the truth of such representations and that this policy embodies all agreements existing between himself and the company or any of its agents relating to this insurance.

IN WITNESS WHEREOF, THE HOME INSURANCE COMPANY, NEW YORK, has caused this policy, with respect to Coverages D, E, E1, F, G, H and I and such other parts of the policy as are applicable thereto, to be executed and attested, but this policy shall not be valid unless countersigned on the declarations page by a duly authorized agent of the company.

Secretary — President

IN WITNESS WHEREOF, THE HOME INDEMNITY COMPANY, NEW YORK, has caused this policy, with respect to Coverages A, B and C and such other parts of the policy as are applicable thereto, to be executed and attested, but this policy shall not be valid unless countersigned on the declarations page by a duly authorized agent of the company.

Secretary — President

PACIFIC
COMBINATION AUTOMOBILE POLICY

NUMBER
CAU 6011452

THE HOME
INSURANCE COMPANY
NEW YORK

AND

THE HOME
INDEMNITY COMPANY
NEW YORK

PLEASE READ YOUR POLICY

Issued to
WALTER HAGGERTY & NORTHUMBERLAND
MINING CO.

Expires DECEMBER 2, 1946
At 12:01 A. M. Standard Time

IMPORTANT

Attention is called to the conditions of this policy which require an immediate notice of loss. No articles shall be replaced or repairs made without such notice or without the consent of this Company. A delay may invalidate your insurance.

If the event of an accident which results in bodily injuries or in damage to or the destruction of property of others, it is absolutely necessary that some occupant of the automobile should at once secure the names and addresses of all bystanders who were in the vicinity and who may possibly have seen the accident.

AUTOMOBILE DEPARTMENT
59 Maiden Lane
NEW YORK, N. Y.

80% COLLISION COVERAGE

In consideration of an additional premium of $ INCLUDED ....., the policy designated below is extended to include coverage as follows:

80% COLLISION COVERAGE Loss of or damage to the automobile caused by collision of the automobile with another object or by upset of the automobile but not exceeding 80% of the first $250.00 and 100% of the amount in excess of $250.00 of each such loss or damage.

This Endorsement is subject to the limits of liability, exclusions, conditions and other terms of such policy which are not inconsistent herewith

This Endorsement, when countersigned by an authorized agent of the Company, and attached to Policy No 37 CAU 6011452

of THE HOME **Insurance Company**, issued to .....

WALTER HAGGERTY etal shall form a part of said policy.

Countersigned at NORTH HOLLYWOOD, CALIF. this 2ND day of DECEMBER 1945

CHESTER DE YOUNG ..... Agent.

Au 320vA 5 A I—SCM 11 45

[27]

AUTOMOBILE DEPARTMENT
59 Maiden Lane
NEW YORK, N. Y.

MEXICAN COVERAGE ENDORSEMENT
for Combination Automobile Policy

It is agreed that the coverage provided by the policy to which this endorsement is attached is extended to apply while any automobile insured hereunder is being operated in the Republic of Mexico for a period not exceeding ten (10) days at any one time subject to the following conditions:

1. Such insurance as is provided by this policy for bodily injury liability or property damage liability shall be excess insurance over any other valid and collectible insurance available to the insured.
2. As respects any loss or damage which may make necessary the repair of the insured automobile or replacement of any part or parts thereof while said automobile is in Mexican territory, under the coverages of Comprehensive, Fire, Theft, Collision, and Combined Additional Coverages, the basis of adjustment of claim for such repairs or replacement shall be the cost of such repairs or replacement at the nearest point in the United States where such repairs or replacement can be made; and it is expressly understood and agreed that the cost of towing or transportation or salvage operations of the insured automobile while within Mexican territory shall not be recoverable hereunder and is not a contingency insured against.
3. In the event any claim for loss or damage under the coverages of Comprehensive, Fire, Theft, Collision, and Combined Additional Coverages is made against this Company while the insured automobile is inside the boundaries of the Republic of Mexico, the sustenance and transportation, or the cost of same, of one adjuster, if one be sent from the nearest United States border town to the location of the damaged automobile, shall be borne by the insured whenever the accident which is the basis of the claim shall have occurred at a point in excess of twenty-five (25) miles from the United States border over a passable highway.

Attached to and forming part of Automobile Policy No. CAU 6011452 issued by

THE HOME **Insurance Company** and **The Home Indemnity Company**

to WALTER HAGGERTY etal

Countersigned at North HOLLYWOOD, CALIF. this 2ND day of DECEMBER 19 45

CHESTER DE YOUNG
Authorized Agent

President

Au 3223—5M 7 46

[Affidavit of Service by Mail]
[Endorsed]: Filed Sep. 24, 1946. [30]

[28]

AMENDMENT OF AUTOMOBILE LIABILITY POLICY

It is agreed that the policy is amended as follows:

1. The following insuring agreement is added:

Bail Bond Expense

The company shall pay the cost of bonds, but without obligation to apply for or furnish such bonds, guaranteeing the insured's appearance in court if such appearance is required by reason of an accident or a traffic law violation occurring during the policy period and arising out of the use of an automobile with respect to which use insurance is afforded such insured under coverage A of this policy. The company's liability under this insuring agreement with respect to each bond shall not exceed the usual charges of surety companies for such bond nor $100.

2. Insuring Agreement V Use of Other Private Passenger Automobiles is amended to read as follows:

V Use of Other Automobiles

Such insurance as is afforded by this policy for bodily injury liability and for property damage liability with respect to the automobile classified as "pleasure and business" applies (1) to the named insured, if an individual and the owner of such automobile, or if husband and wife either or both of whom own such automobile, and (2) to the spouse of such individual if a resident of the same household, the employer of such named insured or spouse, the parent or guardian of such named insured or spouse, if a minor, and a partnership in which such named insured or spouse is a partner, as insured, with respect to the use of any other automobile by or in behalf of such named insured or spouse.

This insuring agreement does not apply:

(a) to any automobile owned in full or in part by, registered in the name of, hired as part of a frequent use of hired automobiles by, or furnished for regular use to, the named insured or a member of his household other than a private chauffeur or domestic servant of the named insured or spouse;

(b) with respect to such employer, parent, guardian or partnership, to any automobile owned in full or in part by him or registered in his name or hired by him as part of a frequent use of hired automobiles;

(c) to any automobile not of the private passenger type while used in the business or occupation of the named insured or spouse, or to any private passenger automobile while used in such business or occupation if operated by a person other than the named insured or spouse or such chauffeur or servant unless the named insured or spouse is present in such automobile;

(d) to any insured other than as defined in this insuring agreement;

(e) to injury to or death of any person who is a named insured;

(f) to any accident arising out of the operation of an automobile repair shop, public garage, sales agency, service station or public parking place.

3. Coverage C—Medical Payments is amended to read as follows:

Coverage C—Medical Payments

To pay to or for each person who sustains bodily injury, caused by accident, while in or upon, entering or alighting from (1) the automobile, if the injury arises out of a use thereof which is insured for bodily injury liability and is by or with the permission of the named insured, or (2) any other automobile with respect to the use of which insurance is afforded under Insuring Agreement V of this policy, if the injury arises out of the use thereof and results from (a) the operation of said automobile by the named insured or spouse or by a private chauffeur or domestic servant of either or (b) the occupancy of said automobile by the named insured or spouse, the reasonable expense of necessary medical, surgical, ambulance, hospital and professional nursing services and, in the event of death resulting from such injury, the reasonable funeral expense, all incurred within one year from the date of accident.

The insurance afforded with respect to such other automobiles shall be excess insurance over any other valid and collectible medical payments insurance applicable thereto.

4. The word "automobile" as used in Coverage C—Medical Payments includes such trailers as are insured for bodily injury liability under the second paragraph of Insuring Agreement "Automobile Defined, Trailers, Two or More Automobiles," and no other trailers.

5. In exclusion (d), the words "or while engaged in the operation, maintenance or repair of the automobile" are deleted in connection with Coverage C—Medical Payments.

This endorsement forms a part of Policy No. CAU 6011452 issued to WALTER HAGGERTY etal
by THE HOME INDEMNITY COMPANY

and is effective from DECEMBER 2ND, 1945
(12:01 A. M. Standard Time)

Countersigned at NORTH HOLLYWOOD, CAL.

By CHESTER DE YOUNG
(Authorized Agent)

President

Form H 6[illegible]-AM 6-[illegible]
Printed in U.S.A.

Admitted December 22, 1950.

* * *

The Court: How is this going to work out? Home put the money up for North Umberland Mining Company, North Umberland Mining Company paid the plaintiff's claims in the San Diego actions and is now entitled to be subrogated to the rights of those plaintiffs against White; is that right?

Mr. Thompson: Under 402(c) of the Vehicle Code.

The Court: So White is going to have to pay this money back to North Umberland who, in turn, will have to pay it back [43] to Home, is that right?

Mr. Armstrong: That is the way I understand it, your Honor.

Mr. Thompson: We are out of the record here, but that is the mechanics.

The Court: I am just trying to find out the mechanics. So actually as a practical matter this is White's claim against the Standard Accident?

Mr. Armstrong: That's right.

The Court: Isn't that right?

Mr. Thompson: That is what they are trying to assert here in an intervention proceeding.

The Court: Go ahead. [44]

* * *

Certificate

I hereby certify that I am a duly appointed, qualified and acting official court reporter of the United States District Court for the Southern District of California.

I further certify that the foregoing is a true and

correct transcript of the proceedings had in the above-entitled cause on the date or dates specified therein, and that said transcript is a true and correct transcription of my stenographic notes.

Dated at Los Angeles, California, this 29th day of December A. D., 1950.

/s/ SAMUEL GOLDSTEIN,
Official Reporter.

[Endorsed]: Filed April 2, 1951.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 90, inclusive, contain the original Complaint in Intervention; Answer of Standard Accident Insurance Company of Detroit to Complaint in Intervention; Memorandum of Points and Authorities in re Issues Raised by Complaint in Intervention and Answers thereto; Findings of Fact and Conclusions of Law; Judgment; Affidavit and Order Extending Time to File Notice of Appeal; Notice of Motion and Motion for Order Reconsidering Ex Parte Order of March 20, 1951, Extending Time to Appeal, etc.; Statement of Reasons in Opposition and Answering Memorandum of Points and Authorities to Plaintiff's Notice of Motion to

Reconsider and Vacate Order Extending Time to Appeal; Notice of Appeal; Designation of Record on Appeal and Statement of Points; Designation of Additional Portions of Record on Appeal; Application and Order Extending Time to Docket Appeal and Stipulation and Order Designating Additional Portions of Record on Appeal and a full, true and correct copy of minute orders entered January 3, 1951, and April 23, 1951; Copy of Opinion of Circuit Court of Appeals for the Ninth Circuit in the case of Home Indemnity Co. of New York v. Standard Acc. Ins. Co. of Detroit et al. as reported in 167 F. 2d 919; and of the Docket Entries which, together with copy of reporter's transcript of proceedings on December 22, 1950, and original Intervener's Exhibits 1 and 2, transmitted herewith, constitute the record on appeal to the United States Court of Appeals for the Ninth Circuit.

I further certify that my fees for preparing and certifying the foregoing record amount to $7.40 which sum has been paid to me by appellant.

Witness my hand and the seal of said District Court this 24th day of May, A. D. 1951.

[Seal] EDMUND L. SMITH,
Clerk,

By /s/ THEODORE HOCKE,
Chief Deputy.

[Endorsed]: No. 12950. United States Court of Appeals for the Ninth Circuit. North Umberland Mining Company, a Corporation, Appellant, vs. Standard Accident Insurance Company, a Corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed May 25, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals for the Ninth Circuit

NORTH UMBERLAND MINING COMPANY, a Corporation,

Appellant,

vs.

STANDARD ACCIDENT INSURANCE COMPANY OF DETROIT, a Corporation,

Appellee.

STATEMENT OF POINTS RELIED ON BY APPELLANT

Appellant proposes its appeal to rely on the following points as error:

1. The District Court erred in holding that the insurance provided for in the policy of Appellee, Standard Accident Insurance Company of Detroit, was excess and not primary coverage as it applied to the defendant George White.

2. The District Court erred in finding that the rights and obligations of defendant George White, defendant Home Indemnity Company of New York, and of Appellee Standard Accident Insurance Company of Detroit, respectively, became fixed at a date not later than the happening of the accident in which the Lincoln automobile driven by George White and covered by the policies of Appellee Standard Accident Insurance Company of Detroit and Home Indemnity Company of New York, occurred.

3. The District Court erred in the finding that the insurance afforded by the policy of Home Indemnity Company of New York was other available collectible insurance at the time of the accident within the meaning of that term as used in the policy of Appellee Standard Accident Insurance Company of Detroit.

4. The District Court erred in not finding that the insurance afforded by defendant Home Indemnity Company of New York did not become other available collectible insurance until all of the conditions precedent contained in said policy had been complied with by George White.

Dated: May 23, 1951.

/s/ DONALD ARMSTRONG,
Attorney for Appellant, North Umberland Mining Company.

Affidavit of Service by Mail attached.

[Endorsed]: Filed May 25, 1951.

[Title of Court of Appeals and Cause.]

STATEMENT OF POINTS ON APPEAL TO BE MADE BY RESPONDENT

I.

United States Court of Appeals for the Ninth Circuit has no jurisdiction to hear this matter on appeal.

II.

The District Court correctly decided that the insurance provided for in the policy of appellee, Standard Accident Insurance Company of Detroit, was excess and not primary coverage as it applied to the defendant, George White.

III.

The District Court correctly decided that the rights and obligations of the defendant, George White, as well as of appellant and appellee, respectively, became fixed as of the day of the accident in which the Lincoln automobile driven by George White was involved.

IV.

The District Court correctly decided that the insurance afforded by the policy of Home Indemnity Company of New York was other available collectible insurance at the time of the accident within the meaning of that term as used in the policy issued by appellee herein.

BAUDER, GILBERT,
THOMPSON & KELLY,

By /s/ EVERETT W. THOMPSON,
Attorneys for Appellee.

Affidavit of Service by Mail attached.

[Endorsed]: Filed May 31, 1951.

No. 12950.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NORTH UMBERLAND MINING COMPANY, a Corporation,

Appellant,

vs.

STANDARD ACCIDENT INSURANCE COMPANY, a Corporation,

Appellee.

APPELLANT NORTH UMBERLAND MINING COMPANY'S OPENING BRIEF.

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IN THE

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Appellant,

vs.

STANDARD ACCIDENT INSURANCE COMPANY, a Corporation,
Appellee.

APPELLANT NORTH UMBERLAND MINING COMPANY'S OPENING BRIEF.

Jurisdiction.

Jurisdiction to review the judgment of the court below is conferred by Title 28, Section 225, of the United States Code. The District Court had jurisdiction by reason of Sections 1332 and 2201, Title 28, of the United States Code, because North Umberland Mining Company, appellant, was a resident and citizen of the State of Nevada, and appellee, Standard Accident Insurance Company, was a citizen and resident of the State of Michigan and the amount in controversy exceeds $3000. [Tr. pp. 3, 4, 9.]

Statement of the Case.[1]

This cause in one of its aspects was determined by this Court in an opinion reported in 167 F. 2d 918.

This litigation began with a controversy over which public liability insurance policy covered the liability of one George White for the death of two persons caused by the operation of an automobile driven by said White, that is whether it was the policy of plaintiff and appellee, Standard Accident Insurance Company of Detroit, or that of defendant, Home Indmenity Company of New York. (Standard Accident Insurance Company of Detroit will hereinafter be referred to as Standard, and Home Indemnity Company of New York will hereinafter be referred to as Home.)

Prior to the accident White owned a Packard automobile and carried a public liability insurance policy with Standard. This policy insured White while driving the Packard or any other car with the permission of its owner against liability for any personal injuries or death to persons by the operation of the Packard automobile or such other automobile. The Standard policy provided by way of exception or proviso that if while driving such other automobile, while the Packard was temporarily out of service, there was other insurance which was valid and *collectible and available* to White, then the insurance provided by the Standard policy was excess insurance. [Int. Ex. 1, Conditions 11 and 13, Tr. p. 57.]

Prior to the accident and subsequent to the issuance of the Standard policy to White, intervener, North Um-

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[1]All facts are admitted and uncontradicted. [Complaint in intervention, pars. VI, VII, VIII, IX, X, XI; answer thereto, par. I, Tr. pp. 4:7, 9; Stipulation pp. 50-52; Opinion 169 F. 2d 918.]

berland Mining Company, the owner of a Lincoln Zephyr automobile, secured a policy of liability insurance covering the Lincoln Zephyr automobile from Home. This policy covered the intervener and any person driving the Lincoln Zephyr with the intervener's permission. The policy further provided as a condition precedent that no action would lie against the company unless all of the conditions of the policy had been fully complied with and the amount of the insured's obligation to pay shall have been finally determined. [Int. Ex. 2, Condition 6, Tr. p. 61.]

At the time of the accident above referred to White was driving the Lincoln Zephyr automobile belonging to intervener, North Umberland Mining Company.

Home after the accident maintained that White was not covered by the terms of its policy because White had failed to comply with one of the conditions precedent in the policy, namely, the condition that he cooperate with the company, and for that reason denied liability.

Thereupon Standard commenced a declaratory relief action in the court below against Home, White and the personal representatives of the two persons who were killed in the accident above mentioned. (These personal representatives had previously commenced actions in the Superior Court of the State of California, in and for the County of San Diego, against White and intervener, North Umberland Mining Company, as the owner of the Lincoln Zephyr.)

At the trial of the issues between Home and Standard the District Court held that White had cooperated and that Home was liable under its policy. Home appealed,

and this Court reversed the trial court in its opinion reported in 167 F. 2d 918.

Pending said appeal the actions brought against White and intervener, North Umberland Mining Company, were reduced to judgments, said judgments being rendered against White and North Umberland Mining Company jointly. [Complaint in Int. par. XI; answer thereto par. I; Tr. pp. 7, 9.]

These judgments were satisfied for and on behalf of intervener, North Umberland Mining Company, White contributing nothing on account thereof.

Upon the coming down of the mandate after the decision in 167 F. 2d 918, intervener, North Umberland Mining Company, filed its petition in intervention in the declaratory relief action against White and Standard to have it declared that White was liable to intervener, North Umberland Mining Company, under Section 402(c) of the Vehicle Code of the State of California which gives the owner of an automobile the right of subrogation against the operator for any amount which the owner has paid as a result of the negligence of such driver and to have it declared that Standard was liable under its policy to White.

The court below gave judgment for intervener, North Umberland Mining Company, against White but declared that Standard was liable to no one under its policy, because that insurance was excess insurance, the Home policy being collectible insurance on the day of the accident. [Tr. pp. 35, 36.]

Questions Involved.

Standard maintained, and the District Court held, at the trial between Standard and intervener, North Umberland Mining Company, that the insurance of Standard became excess insurance and not primary insurance not later than the time of the accident [Tr. p. 32], thereby holding that the insurance afforded by Home became collectible and available prior to the accident whether White complied with the conditions precedent contained in Home's policy or not or whether the amount of White's liability to pay had been finally determined. Condition 6 of Home's policy reads as follows: "No action shall lie against the company unless, *as a condition precedent thereto,** the insured shall have fully complied with all the terms of this policy, nor until the amount of the insured's obligation to pay shall *have been finally determined either by judgment* against the insured after actual trial *or by written agreement of the insured, the claimant and the company.*" [Tr. p. 61, Int. Ex. 2.]

Intervener, North Umberland Mining Company, maintained that the Home policy never became available or collectible insurance because the conditions precedent above referred to had not been complied with and that therefore the Standard policy never became excess insurance and at all times remained primary insurance, and that in any event it could not be determined from the terms of Standard's policy when, if ever, Standard's insurance became excess insurance.

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*Emphasis ours unless otherwise indicated.

The trial court on this issue found as follows:

> "That the insurance afforded by the policy of plaintiff, Standard Accident Insurance Company of Detroit, was and now is solely excess insurance over and above a sum equal to the limits of the insurance afforded to the defendant George White by the policy of Home Indemnity Company of New York, and which lattter insurance *was valid and collectible and available to George White at the time of said accident.*" [Tr. p. 33.]

It was stipulated at the trial of the issues raised by intervener's petition in intervention and Standard's answer thereto that the facts recited in the opinion of this Court and reported in 167 F. 2d 918 should be considered as evidence by the court in that proceeding. [Tr. p. 50.]

Appellant maintains on this appeal that the District Court erred in holding that the insurance afforded by Standard's policy was excess insurance at the time of the accident and in declaring by its decree that Standard is not obligated to anyone under the terms of its policy and in not finding that Standard was the primary insurance carrier for White and liable to reimburse intervener for the money laid out by it in satisfying the judgments against White. (Intervener as owner of the Lincoln was liable up to $10,000.00 under Section 402 of the California Vehicle Code.)

Manner in Which Questions Raised.

These questions were all raised by intervener's petition in intervention and Standard's answer thereto. [Tr. pp. 7, 8, 9, 11, 12.]

Specifications of Error.

1. The District Court erred in declaring that plaintiff, Standard Accident Insurance Company of Detroit, was not obligated to anyone under the terms of its policy.

2. The District Court erred in holding that the insurance afforded George White by the policy of Home Indemnity Company of New York was valid and collectible and available to George White at the time of the accident.

3. The District Court erred in not declaring that Standard Accident Insurance Company of Detroit was obligated to George White in the sum of $8,750.00, together with interest thereon at the rate of seven percent per annum from and after January 19, 1948, under the terms of its policy.

4. The District Court erred in not holding that the insurance afforded by Standard Accident Insurance Company of Detroit by the terms of its policy insuring George White was at all times primary insurance and at no time ever became excess insurance.

ARGUMENT.

The Facts.[2]

The relevant controlling facts material to the issues briefly stated are as follows:

George White on September 29, 1945, owned a 1942 Packard automobile. On that date Standard issued to White its automobile bodily injury liability policy insuring George White against liability for damages caused by bodily injury including death arising out of the ownership or operation of said 1942 Packard automobile. The policy further provided that in the event the Packard automobile was being repaired White would be protected by the policy while he was driving a substitute automobile with the permission of its owner. Thus, Standard was White's primary insurer while driving the Packard automobile owned by him or while driving a substitute automobile.

By way of exception and proviso the Standard policy provided as follows:

> "provided, however, the insurance under Insuring Agreements VII and VIII *shall be excess insurance over any other valid and collectible insurance available to the insured,* either as an insured under a policy applicable with respect to the automobile or otherwise, against a loss covered under either or both of the insuring agreements." [Tr. p. 57.] (Insurance agreement VIII above referred to covers driving of substitute automobiles.)

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[2]As stated in footnote 1, the facts are all admitted and uncontradicted.

The Standard policy covered a period commencing September 29, 1945, and ending September 29, 1946.

On December 2, 1945, intervener, North Umberland Mining Company, was the owner of a Lincoln Zephyr automobile. On that date Home issued to intervener and others its liability policy for a period commencing December 2, 1945, and ending December 2, 1946, which policy insured intervener or anyone driving the same with the permission of the owner against damages caused by the injury or death of any person or persons caused by the operation of said automobile. This policy specifies that,

> "*no action shall lie* against the company *unless as a condition precedent thereto the insured shall have fully complied with all of the terms of this policy nor until the amount of the insured's obligation to pay shall have been finally determined* either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company." [Tr. p. 61.]

On July 20, 1946, White's Packard automobile was under repair, and with the consent of intervener White was driving the Lincoln Zephyr automobile owned by intervener and while so driving said automobile he ran over Claude McLester Lee and Leana Mae Osborne Lee, and as a result of the injuries sustained in said collision the two persons last mentioned died.

Home maintained that White failed to comply with the condition precedent that White cooperate, and de-

nied liability. This court held in a comprehensive opinion that White had failed to cooperate and therefore Home was not liable under its policy. (167 F. 2d 918.) The personal representatives of Claude McLester Lee and Leana Mae Osborne Lee commenced actions in the Superior Court of the State of California, in and for the County of San Diego, against George White and intervener, North Umberland Mining Company, for their wrongful deaths. White was sued as the operator of the vehicle and intervener as the owner and therefore liable under Section 402(2) of the California Vehicle Code which imputes to the owner of a vehicle the negligence and liability therefor of a person driving such automobile with the owner's consent. [Tr. pp. 5, 6, 9.] (These facts are all admitted by the pleadings.)

Thereafter judgments were entered in said actions against White and intervener in sums aggregating $8,-750.00, and these judgments were satisfied for and on behalf of intervener, White contributing nothing. [Tr. pp. 7, 52.] It was stipulated that the facts concerning the satisfaction of the judgment alleged in the petition in intervention were true. [Tr. p. 52.]

The trial court held that White was liable to intervener for the amounts of the judgments under Section 402(d) of the California Vehicle Code, but that Standard was liable to no one under its policy. [Tr. p. 35.]

A. Standard's Policy Insuring George White Was Always Primary Insurance and Never Became Excess Insurance.

(1) A Reasonable and Fair Construction of the Controlling Provisions of Standard's Policy Insuring White and Home's Policy Insuring Intervener Leads to One Conclusion and That Is That Standard's Insurance Never Became Excess Insurance.

The decision on this appeal turns on the question when, if ever, did the insurance afforded by the Home policy become "valid and collectible insurance available to" George White. It is our position that the controlling provisions of the Home policy and the Standard policy fairly construed leads to one logical conclusion and that is that the Standard insurance never did become excess insurance.

The Standard policy insuring White's Packard and insuring White as well when he was driving another automobile while the Packard was temporarily out of use provided as an exception to such insurance that it became excess insurance only in the event that there was available to White other collectible insurance. Standard contends, and the trial court found, that the Home policy constituted collectible insurance either before the happening, or at least by the time of the happening, of the accident. This position flies in the face of the express provisions of the Home policy.

The Home policy provides to quote from the opinion of this court reported in 169 F. 2d 918, as follows:

> "The appellant's policy (referring to the Home policy) specifies that 'No action shall lie against the company unless, as a condition precedent thereto, the

> insured shall have fully complied with all the terms of this policy.' There is nothing contrary to public policy in this provision, and it should be enforced according to its terms.
>
> "Under the Civil Code of California, a condition precedent is given the same force as that indicated in the policy that we are now considering. Section 1439 provides in part:
>
> " 'Before any party to an obligation can require another party to perform any act under it, he must fulfill all conditions precedent thereto imposed upon himself; * * *.' "

But in addition, the Home policy contains another condition precedent that must be complied with before an action will lie upon the policy, namely, that no action shall lie until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company.

At the time of the accident none of these conditions had been met. This court, in referring to the conditions contained in the Home policy, quoted from *Whittle v. Associated Indemnity Corp.,* 130 N. J. L. 576, 33 A. 2d 868, 869, as follows:

> "Was a condition precedent of the policy unfulfilled by the assured? If it was then, if the insurer so chooses and it did so choose, the policy is at an end * * *, for 'there has been a failure to fulfill a condition upon which (insurer's) obligation is dependent.' "

And further quoted from the *Coleman* case as follows:

> "And if the "insured cannot bring himself within the conditions of the policy, he is not entitled to recover for the loss.' * * * In short, the law does not make a better contract for the parties than they chose to make for themselves."

How can it be said that insurance is collectible before the insured under the policy has met and complied with the conditions precedent making the company liable under the policy?

Moreover, Home never became liable to White under its policy, and the policy was never therefore collectible by White because White failed to comply with the co-operative condition of the policy. (169 F. 2d 918.)

(2) The Holding of the Trial Court That Standard's Insurance Became Excess Insurance Does Violence to Every Principle of Construction Applicable to Insurance Policies.

The Standard policy is indefinite as to when other insurance is deemed to be available and collectible, and for that matter does not define collectible at all. The provision in Standard's policy, moreover, is an exception or proviso, the clause reading in part as follows:

> "Provided, however, the insurance under insurance agreements VII and VIII shall be excess insurance over any other valid and collectible insurance available to the insured * * *." [Int. Ex. 1, Tr. p. 57.]

The draftsman of the Standard policy, if he had so desired and the company, if it had so desired, could have

made plain and explicit what they left uncertain and ambiguous. The best that can be said of this provision of Standard's policy is that it is reasonably open to two constructions. One construction is that the policy can be construed to mean that Home's insurance became collectible some time prior to the accident (which we, of course, emphatically deny) and the other is that it did not become collectible until all of the conditions precedent contained in Home's policy had been complied with.

Thus, it follows that the decision of the trial court flies in the face of settled rules of construction relating to insurance contracts.

The first of these rules is that where two insurance companies are trying to avoid liability for the same risk, the court will not construe the policies so as to make neither liable. (*Zurich General Accident and Liability Insurance Company v. Clamor* (7 Cir.), 124 F. 2d 717.) But this is exactly what the lower court did in holding that Standard's insurance was excess and not primary insurance at the time of the accident and in holding that Standard was liable to no one under its policy.

Another rule is that exceptions in insurance policies are to be construed strongly against the insurer and in favor of the insured and if susceptible of two meanings, the one more favorable to the insured is to be adopted. (*Mah See v. North American Accident Insurance Company,* 190 Cal. 421, 424, 213 Pac. 42.) The trial court's judgment violated this rule. The provision in the Standard policy undertaking to make the insurance under its policy excess insurance is clearly an exception and an exception to limit the risk assumed by Standard.

Another rule is that indemnification of the insured should be affected rather than defeated. (*Glickman v. New York Life nsurance Company,* 16 Cal. 2d 626, 635, 107 P. 2d 252, 256.) The decision of the District Court defeats rather than affects indemnification in the case at bar.

Another rule is that an insurance carrier is bound to use language as to make its exceptions and provisions of its contract clear to the ordinary mind, and in case it fails to do so any uncertainty or reasonable doubt is to be resolved against it. (*Pacific Heating and Ventilating Co. v. Williamsburg Fire Insurance Company,* 158 Cal. 367, 370, 111 Pac. 4.) Standard could have made its policy clear and explicit in this regard, but it deliberately failed to do so.

The rules of construction just above stated have all been collected and applied to automobile liability policies in *Read v. Pacific Indemnity Co.,* 101 A. C. A. 177, 225 P. 2d 255.

The late Honorable J. F. T. O'Connor, the Judge who presided at the first trial of this cause upon the coming down of the mandate and speaking of the position advanced by Standard and adopted by the trial court on this appeal had this to say:

> "All of these theories, however, fairly consistent among themselves, seem fantastic to the court, and not worthy of the court's consideration, for such a construction would not be in accordance with the clear provisions of the policy of the Standard if the policy, relative to the point involved, is to be construed literally. It says that this 'primary' insurance

'. . . *shall be excess insurance over any other valid and collectible insurance available to the insured.*'*

"Having in mind that an insurance policy is a contract and that the intendments thereof are to be interpreted most strongly in favor of the assured, particularly where the contract is drawn up by the insurer, this court would naturally assume, without judicially deciding this point at this time, that the provision that the insurance of White in the Standard 'shall be excess insurance over any other valid and collectible insurance available to the insured' means only upon the actual payment of any claim in this case by the Home up to the limits of its liability; and that if, for any reason, the Home did not pay the claim, either because of insolvency, or because of a breach of a condition by White, or for any other reason, the 'primary' insurance in the Standard would not become 'excess' insurance, and . . .

"If the Standard wanted its policy to be interpreted according to the present contention of its counsel, it seems to the court that it would have been an easy matter to have used appropriate language to that effect. The present analysis of this policy provision would appear to reduce the Standard's contention to a '*reductio ad absurdum.*' "

This analysis by Judge O'Connor is sound, and it is submitted should be followed by this court.

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*Emphasis the Court's.

Conclusion.

The judgment of the lower court should be reversed with directions.

Respectfully submitted,

DONALD ARMSTRONG,
Attorney for Appellant.

No. 12950.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NORTH UMBERLAND MINING COMPANY, a Corporation,
Appellant,

vs.

STANDARD ACCIDENT INSURANCE COMPANY, a Corporation,
Appellee.

APPELLEE'S REPLY BRIEF.

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Appellee.

APPELLEE'S REPLY BRIEF.

Preliminary Statement.

Appellee, Standard Accident Insurance Company (hereinafter called "Standard"), brought an action in the District Court of the United States, Southern District of California, to have it declared that Home Indemnity Company of New York (hereinafter referred to as "Home") was obligated to defend one George White in two actions brought against said White in the Superior Court of San Diego County to recover from said White damages for alleged wrongful death. They were alleged to have resulted from White's operation of an automobile owned by North Umberland Mining Company (hereinafter called "North Umberland") with its consent. The District Court held that the obligation to defend White rested with Home. Home appealed to this Honorable Court which

held that White had breached the co-operation clause of the Home policy and that Home was not required to defend White in said Superior Court action. This decision is reported in 167 F. 2d 919.

Judgments were entered against White and North Umberland, by stipulation. Standard did not join in these stipulations. [R. 50-51.] The judgments were paid by Home on behalf of and for its assured [R. 52, 65] North Umberland. Thereafter North Umberland filed a complaint in intervention in this case, praying that it be declared that Standard is obligated to White under its policy of insurance issued to White in the amount of the judgment which "North Umberland had paid."

The District Court, Honorable James M. Carter, Judge, found contrary to this contention and entered judgment to the effect that North Umberland has a right to recover from White, but that Standard, under its policy, is neither obligated to White nor to North Umberland.

This appeal followed.

Jurisdiction of the United States District Court.

The District Court had jurisdiction of the original action by reason of the diversity of citizenship of the original plaintiff and defendant, the one being a citizen of Michigan, the other a citizen of New York, and by reason of the fact that the controversy exceeded the sum of three thousand dollars. It had jurisdiction of the controversy between intervener North Umberland and Standard because those parties, likewise, are citizens of different states, to wit, of Nevada and Michigan, respectively, and their controversy exceeds three thousand dollars. [See R. pp. 3, 4, 9, Sections 1332 and 2201 of Title 28, United States Code.]

Jurisdiction of the Court of Appeals.

This Honorable Court is empowered to review the case under Title 28, Section 225, United States Code.

Statement of Facts.

The facts of the case are not in dispute and are, for the greater part, contained in the opinion reported in 167 F. 2d 919. The following statement may serve as a summary of that opinion and of pertinent portions of the present record on appeal.

Standard, on September 29, 1945, issued its policy of insurance to George White, insuring a 1942 Packard automobile belonging to White. [R. 55.] It provided, among other things, for coverage of other automobiles which White might drive, as follows:

> "VIII. Temporary Use of Substitute Automobile . . . While an automobile owned in full or in part by the named insured is withdrawn from normal use because of its breakdown, repair, servicing, loss or destruction, such insurance as is afforded by this policy with respect to such automobile applies with respect to another automobile not so owned while temporarily used as the substitute for such automobile. This insuring agreement does not cover as an insured the owner of the substitute automobile or any employee of such owner." [R. 56.]

The policy likewise provided as follows:

> ". . . If the insured has other insurance against a loss covered by this policy the company shall not

be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the declarations bears to the total applicable limit of liability of all valid and collectible insurance against such loss; provided, however, the insurance under Insuring Agreements VII and VIII shall be excess insurance over any other valid and collectible insurance available to the insured, either as an insured under a policy applicable with respect to the automobile or otherwise, against a loss covered under either or both of said insuring agreements." [R. 57.]

On July 20, 1946, White's Packard was temporarily out of use by reason of repairs. On that day North Umberland permitted White to drive a Lincoln automobile belonging to North Umberland. At the time North Umberland had a policy of insurance with Home, issued November 30, 1945. This policy insured and named as the vehicle it covered the Lincoln Zephyr automobile which White was driving with the consent of North Umberland at the time of the accident [R. 59], this policy contained the provision that it insured

"any person while using the automobile and any person or organization legally responsible for the use thereof, provided the actual use of the automobile is within the permission of the named insured." [R. 60.]

While driving this Lincoln Zephyr, White had an accident by reason of which he was sued in the Superior Court of San Diego County, as previously stated. The

acts of White subsequent to the accident as far as it concerns co-operation with Home is described in the opinion in 167 F. 2d 919, and will not be detailed here. Suffice it to say that his conduct after the happening of the accident was such that Home in the decision reported in 167 F. 2d 919, was excused from defending White by reason of the latter's lack of co-operation with Home in the defense of the San Diego actions. While that appeal was pending, intervenor, North Umberland, and plaintiffs in the San Diego actions stipulated for judgment in favor of said plaintiffs and against White in the aggregate of eight thousand seven hundred and fifty dollars ($8,750.00). This judgment was thereafter satisfied as already indicated.

Standard did not participate in the San Diego proceedings at any stage or in any manner.

North Umberland now claims that by reason of satisfying said judgment it has acquired whatever rights White had against Standard under White's policy with Standard [R. 55], and, moreover, contends that under said policy Standard is now obligated to repay to North Umberland the money paid, with interest these judgments to which White and North Umberland had stipulated.

Summary of Pleadings.

The contentions just stated are elaborated in the complaint in intervention of North Umberland [R. 3-9] in which it is alleged that two actions were brought in San Diego County against White and North Umberland, that judgments were entered against White and North Umberland in these actions in the total sum of eight thousand seven hundred fifty dollars ($8,750.00), that Standard is liable to White under its policy of insurance and that North Umberland, having paid for and on behalf of White, is entitled to recover the amount it paid from Standard.

The answer admits all facts pleaded in the complaint but denies that under its policy, or otherwise, it owes any money whatsoever to White or to North Umberland. [R. 9-13.]

Findings of Fact and Conclusions of Law followed [R. 24-34], which state, in greater detail than we have done here, the undisputed facts leading to this controversy. The decisive finding is par. XVII, which reads as follows:

> "The court finds that the rights and liabilities of defendant George White, defendant Home Indemnity Company of New York, and plaintiff Standard Accident Insurance Company of Detroit, became and were fixed not later than the time of the accident above referred to; that at the time of said accident George White had other valid and collectible and available insurance within the meaning of the provisions of the policy issued to him by Standard Accident Insurance Company of New York, namely, the insurance provided for and afforded to him by the policy issued to the intervener, North Umberland Mining Company, by defendant Home Indemnity Company of New York; that the subsequent breach of the provisions

and conditions of the policy of insurance of Home Indemnity Company of New York by the defendant George White did not alter or change the rights or liabilities of the plaintiff, Standard Accident Insurance Company of Detroit, as the excess carrier; that the insurance afforded by the policy of plaintiff, Standard Accident Insurance Company of Detroit, was and now is solely excess insurance over and above a sum equal to the limits of the insurance afforded to the defendant George White by the policy of Home Indemnity Company of New York, and which latter insurance was (30) valid and collectible and available to George White at the time of said accident." [R. 32.]

Based on these Findings the Court concluded [R. 33] that White was obligated to North Umberland, but that Standard was not obligated to anyone under its policy.

Summary of Proceedings Subsequent to Entry of Judgment.

Inasmuch as we believe that this appeal was not instituted in time, it will be necessary to summarize briefly proceedings taken in the District Court after judgment. Judgment herein was filed January 25, 1951. [R. 36.]

On March 20, 1951, appellant made an *ex parte* application for an extension of time to file notice of appeal. The application was based on an affidavit of appellant's attorney. [R. 36-37.] This affidavit assigned as a ground that appellant's attorney "was not aware of the entry of said judgment and did not receive notice of such entry."

[R. 37.] On this *ex parte* application an order was made on March 20 extending the time for appeal to March 26 [R. 37], and the notice of appeal thereupon was filed on March 22. [R. 46.]

Standard, upon receiving the notice of appeal made a motion [R. 38-39] to strike the order of March 20, on the ground that the records of the District Court, including the civil docket, show that notice of entry of judgment had been sent to North Umberland and that, on the other hand, notice of the application for extension of time was not given to Standard and that an *ex parte* application for extension of time to file a notice of appeal under these circumstances and after the original time for appeal had expired was null and void. This motion [R. 38-39] was accompanied by an affidavit of Standard's attorney, Everett W. Thompson [R. 42-45] pointing out that the docket shows the sending of this notice to all attorneys, that the proceedings extending the time to file the notice of appeal were not taken on motion as required by Rule 6(b) of the Rules of Civil Procedure and that the grounds stated in the affidavit were not sufficient to grant such an extension. The allegations of this affidavit were not controverted.

After argument to the District Court the minute order of April 23 [R. 47] resulted, which declined to rule on the motion because if the order was a voidable one, the appeal robbed the Court of jurisdiction to do anything further; if, however, it was a void one, no action to set it aside was necessary.

Questions Presented.

I. Is the *ex parte* order of March 20, 1951, a proper exercise of the powers of the District Court, and did it validly extend North Umberland's time to appeal, or is said order void and of no effect?

II. Was the District Court correct in deciding that the protection which White undoubtedly had at the time he stepped into North Umberland's Lincoln Zephyr automobile with North Umberland's permission, and at the time of the accident "valid and collectible insurance available to the insured," as this term is used in the policy of Standard?

III. Was the District Court right in holding that Standard was not obligated to appellant or White in any sum under its policy of insurance with White, and that the insurance provided in its policy never became primary insurance?

Summary of Argument.

1. North Umberland, by reason of its payment of the judgment against White asserts certain rights against Standard under White's policy with Standard. These rights cannot be any greater than White's rights against Standard and North Umberland is in exactly the same position toward Standard as White would be.

2. At the moment of the accident, the rights of White under his policy with Standard became fixed and crystallized.

3. White's failure to co-operate with Home subsequent to the accident could not convert the "valid and collectible" insurance afforded to White under the Home policy at the moment the accident by voluntary acts of his into invalid and uncollectible insurance, and thereby affect the right of Standard.

I.

North Umberland, Seeking to Avail Itself of White's Alleged Rights Against Standard Can Be in No Better Position Than White Himself.

The proposition stated in the heading is the self-evident starting point for the entire argument on this appeal. We submit there is no need to belabor it and the following list of authorities establishing this general proposition will suffice:

Firemen's Fund etc. v. Kennedy, 97 F. 2d 882 (9th Cir.);

Fageol Truck v. Pacific Indemnity, 18 Cal. 2d 731, 117 P. 2d 669;

Royal Indemnity Co. v. Evatson, 61 F. 2d 614.

II.

At the Moment of the Accident, the Rights of White Under His Policy With Standard Became Fixed and Crystallized.

The important difference between Standard's and North Umberland's position is this: North Umberland maintains that what is "valid and collectible insurance available to the insured" under the terms of the Standard policy did not become determinable at the moment when the accident happened, but that we had to wait and see whether White would not do something after the accident to defeat the obligation Home had to White at the moment of the accident. Standard contends that it is not within the power of White to change by voluntary acts after the accident the nature of the obligation of Standard toward him, that is, in other words, that White does not have the power by his own voluntary and, we may add,

wrongful act, to change what was clearly excess insurance under the Standard policy at the moment of the accident into primary insurance.

As the quotations from and references to the Standard policy have shown, it covers one specific automobile, to wit, a Packard. It does not generally cover any other. Under certain specific and well-defined conditions some type of protection is extended to White if he drives another automobile than the Packard. Those conditions are that if the Packard is laid up for repairs, any substitute automobile will also be covered. That extension is, however, not all-inclusive. The substitute automobile is covered only with a particular type of insurance depending on whether or not the use of the substitute automobile (here the Lincoln Zephyr) is protected by other insurance covering permissive use by White. If there is no other valid and collectible insurance, then Standard's protection to White while driving an automobile other than the Packard is primary insurance; if the use of an automobile other than the Packard while driven by White is covered by other valid and collectible insurance, Standard's protection becomes excess insurance.

In this case the judgment amounted to eight thousand seven hundred fifty dollars ($8,750.00); the Home policy was in a face amount in excess of this sum. If, then, the Home policy was valid and collectible, the Standard protection was excess insurance, which came into play only in the event the "valid and collectible" insurance was first exhausted.

The pivotal questions are:

A. What is meant by "other valid and collectible insurance available to the insured?"

B. At what moment do we determine whether other insurance is "valid and collectible," and "available to the insured"?

A. What Is "Other Valid and Collectible Insurance Available to the Insured?"

Appellant in its argument makes a fundamentally erroneous assumption as to the meaning of "valid and collectible." It argues that insurance did not become valid and collectible under its policy until White had fully cooperated with Home in the defense of the lawsuit, and that since he did not do that, the insurance never became valid and collectible.

We submit that this argument does not even have a superficial plausibility. Unless, for reasons deriving from the general law of contract, no meeting of the minds is present or no other reason which makes contracts void generally, this contract of insurance was "valid" the moment the Home policy was issued, to wit, on November 30, 1945; whereas the accident did not happen until June 20, 1946. From December 2, 1945, Home at all times had an obligation to assume certain duties of defense and payment in respect to all accidents which were covered under the terms and provisions of its policy. On that day the insurance became valid. It follows that at the moment White stepped into the Lincoln Zephyr automobile and at the moment the accident happened there was other valid insurance covering White's driving on that particular day. We do not believe that much citation of authorities is necessary for so elementary a proposition. But, see a

general discussion in 29 Am. Jur., Insurance, par. 219, *et seq.*

Did White's acts subsequent to the happening of the accident render the policy invalid? The answer is, we submit, a plain "No." It is on the assumption that the terms of the policy which Home invokes were valid that it now seeks to be excused from payment. The co-operation clause is not a condition subsequent that makes the policy invalid, but it is a condition precedent, as the policy itself plainly states, and this court has announced, to the institution of *an action* to collect on the policy. We quote, just as North Umberland has quoted, the pertinent provision from the Home policy.

> "no action shall lie against the company unless as a condition precedent thereto (this clearly means precedent to the bringing of an action) the insured shall have fully complied with all of the terms of this policy nor until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company." [Tr. p. 61.]

The Home policy of insurance therefore was clearly and indisputably a valid contract of insurance. The breach of the co-operation clause did not wipe out the policy, nor make it invalid. The parties even now judge their position and their respective obligations by its terms. To illustrate further that the Home policy was valid and to show beyond peradventure that the time of the accident is the time when the rights of the parties become fixed, let us look at some cases deciding the position of a man like White between two insurers like Standard and Home, where he co-operates after the accident. In other

words, let us see what the authorities indicate would have been the result here if White had not breached the co-operation clause in the Home policy.

This question was under consideration in *Travelers Indemnity Company v. State Auto Insurance Company,* 66 Ohio App. 457, 37 N. E. 2d 198. In analyzing that opinion we shall refer to the companies as "Travelers" and "State" respectively. State issued to the father, owner of an Oldsmobile, its policy containing generally the same provisions as to the matters here in dispute as the Home policy. Thus it provided in substance that if the owner of the Oldsmobile gave consent to another to drive the Oldsmobile, the insurance extended to such driver. Travelers had issued a policy to the son covering a Packard. This Travelers policy to the son had a clause to the effect that if the son drove a car other than the Packard and such other car was covered by insurance, then the Travelers policy should be "excess insurance over any other valid and collectible insurance available to the insured." The son operated the father's Oldsmobile and had an accident. State, similar to Home in our case, contended it was not liable, claiming that the Travelers policy covered the accident and that the exclusion in its policy in the event of other valid insurance would apply. Travelers did not accede to that contention, refused to defend the son and denied any liability except for amounts in excess of the limit of the State policy. It was decided in the lower court that the State policy was primary insurance and the Travelers policy was excess insurance, and the Court found it quite apparent that Travelers was not liable except for amounts over and in excess of the limits of the State policy. Since the claim of the injured person did not exceed the limits of the State policy the excess insurance of Travelers, it was held, *never came into play.*

This case clearly shows that the liability of the parties is to be determined as of the moment of the accident. Applied to our case this means that at the moment of the accident, the insurance provided by Standard was excess insurance, whereas that provided under the Home policy to White was primary insurance. Consequently, it could *never come into play* until and unless the judgment against White was over and in excess of the Home policy limits.

A similar situation was discussed in *State Farm Mutual Auto Insurance Company v. Hall*, 292 Ky. 22, 165 S. W. 2d 838. In this case one Hall and one Chancellor went on a trip in Chancellor's car which Hall drove with Chancellor's permission. Hall had a policy with State Farm Mutual similar to the Standard policy and Chancellor had one with another insurance company similar to the Home policy. An accident occurred as a result of which a judgment was recovered against Hall in the sum of $2,500.00. Chancellor's policy, which had a limit of $5,000, and was therefore ample to cover the judgment, had to be resorted to first and Hall's policy was considered to provide only insurance by way of excess coverage over Chancellor's policy. The wording of Hall's policy in this respect is identical with ours (see 165 S. W. 2d at p. 839, 2nd col.). The Court stated on page 840:

> "Under a policy similar to Mutual's," (insurer of Hall and therefore occupying the same position as Standard in our case) "and under facts quite like those appearing in this record, courts of other jurisdictions have upheld the plea that an insurer occupying Mutual's position in the instant case is only liable for excess insurance."

To the same effect, see *Trinity Universal Insurance Company v. General Accident etc. Corporation,* 138 Ohio St. 488, 35 N. E. 2d 836.

In these cases the date of the accident is assumed, as a matter of course, as the point of time which determines the respective rights and obligations of the insurers and whether their coverage is primary or excess coverage. Under the cases cited later under this point, particularly under *Air Transport v. Employers,* 91 Cal. App. 2d 129 at 131, and *Maryland Casualty Company v. Hubbard,* 22 Fed. Supp. 697, express mention is made that the point of time which fixes the liability of respective insurers *is the moment when the accident happens.* This means that White, at the moment the accident happened, had valid primary insurance with Home, and from that moment on nothing but his own failure to cooperate could defeat this primary right.

B. Was the Insurance Collectible?

As we have seen, the first of the twin conditions of "valid and collectible" was clearly present. What about the other, namely, "collectible"? Was this insurance collectible?

Stated in the most common language, the term "collectible" in this instance certainly means that Standard said to White, "If when you drive an automobile other than the Packard, there is insurance on this other automobile which you can collect we cover you only by way of excess insurance over that collectible insurance." Would it be fair and proper to say that it was within the power of White by his own wrongful act to forfeit his right to "collect" insurance "available to him" and by such wrong-

ful act change what was a collectible item into an uncollectible one?

There can be no doubt that North Umberland stands before Standard in White's shoes. Suppose White had paid this judgment out of his own pocket, could he now prevail against Standard by maintaining that the terms of the Standard policy placed the right and power *in his hands* to change what was clearly collectible at the moment of the accident into something uncollectible and then come to Standard and say, "It is true, I could have collected on the Home policy; in fact at the moment of the accident I did have rights under the Home policy, but I decided to forego or forfeit those rights and throw the burden of the loss back on you?" Every sense of propriety and justice gasps at such a proposition.

It is for that reason, if for no others, that the rule of law wisely provides that *the rights of the parties under policies of insurance become fixed at the moment of the accident.* That certainly is the general rule and was so declared in *Air Transport v. Employers etc.*, 91 Cal. App. 2d 129 at 131, 204 P. 2d 647. The reasoning and logic of this case is applicable to the case at bar. It is true the question in that decision was not between primary and excess insurance but between concurrent and pro rata insurance, but the underlying considerations are the same. In that case the Court said on page 131:

> "To determine the liability of Employers at this time, if any, we must first determine the respective liabilities, if any, of Employers and Pacific Indemnity *at the date of the accident.*" (Emphasis ours.)

If we substitute Home and Standard for Employers and Pacific Indemnity, and primary and excess in place of concurrent and pro rata insurance in the case just cited,

it follows logically and naturally that the obligation of the parties in this case are fixed as of the time of the accident and remain fixed as far as these parties are concerned, even though White wrongfully chose to vitiate by his own wrongful act the protection he had under the Home policy to start with. Other cases and authorities to the same effect are:

Zurich v. Clamor, 124 F. 2d 717; [16]

Gutner v. Switzerland, 32 F. 2d 700;

Air Transport v. Employers, etc., 91 Cal. App. 2d 129, at 131, 204 P. 2d 647;

Gillies v. Michigan Millers, etc. Ins. Co. (Aug. 18, 1950), 98 A. C. A. 959, at 957;

Maryland Casualty Co. v. Hubbard, 22 Fed. Supp. 697 (1938, U. S. D. C., Judge Yankwich);

Lehigh Valley, etc. v. Providence, etc., 127 Fed. 364;

Couch on Insurance, Vol. 5, p. 3636, note 12.

III.

Was the District Court Right in Holding That Standard Was Not Obligated to George White in Any Sum Under Its Policy of Insurance With White, and That the Insurance Provided in Its Policy Never Became Primary Insurance?

In the light of the considerations just expressed in point II, the District Court was bound to hold, *first,* that at the time of the accident White's protection under the Home policy was "valid and collectible" and "available to him" and therefore constituted "other valid and collectible insurance available to the insured"; that it remained such except for the wrongful acts of White, but that such wrongful acts

could not alter the situation of the parties which became fixed on the date of the accident.

Consequently, North Umberland has a claim to be reimbursed by White (under Section 402 of the California Vehicle Code), but since White has no claim against Standard, North Umberland likewise cannot recover from Standard.

IV.

Reply to the Argument of North Umberland.

North Umberland argues (App. Br. p. 12) that at the time of the happening of the accident there were two conditions precedent which first had to be met before this policy became collectible. It cannot cite any authority in support of this statement although it refers to the former opinion in 167 F. 2d 919. This case held no more than that White had failed to co-operate and that, therefore, Home did not have to provide him with a defense. It made no finding on the validity or invalidity of the policy. On the contrary, it had to consider the policy as a valid and existing contract in order to reach the result it did.

Indirectly, North Umberland maintains that the time of the accident is not a proper time to fix the rights of the parties in this case because at that time the amount of the recovery was not ascertained, nor was it certain at that time whether White would co-operate or not. But again, these are conditions to the institution of an action to re-

cover amounts paid by the insured, and not conditions which invalidate the policy.

The only other argument North Umberland makes is to the effect that the interpretation of the words "other valid and collectible insurance available to" White, which the trial court adopted, does violence to well-known rules of construction of insurance contracts. This is not so. Other courts have been called upon to say what the term "valid and collectible" means and have said in *American Lumbermen's etc. v. Lumber Mutual Casualty Company,* 295 N. Y. Supp. 321:

> "We interpret the words 'total amount of collectible and valid insurance' to mean insurance which is capable of protecting the insured. It merely excludes invalid or illegal insurance (such as insurance which is voidable for misrepresentation) and uncollectible insurance (such as insurance of an insolvent company) from the computation of total insurance for the purposes of apportionment. These words were so construed by this court in Balzer v. Glove Indemnity Co., 206 N. Y. S. 777, in Lamb v. Belt Casualty Co., 3 C. A. (2) 624, 40 Pac. (2) 311, and the same interpretation was adopted by the California court."

The general rules of construction discussed on pages 14 to 15 of appellant's brief are valid enough, but the word "collectible," both from a standpoint of common sense and from the standpoint of authority just cited cannot mean that an insured (in this case, White), can make uncollectible by his own wrongful act that which

he could have collected had he co-operated with Home and then come to Standard and say,

> "The other insurance which was available to me has become uncollectible because I chose not to co-operate with the other insurer. Therefore may I please ask you now to pay the judgment recovered against me, which the other insurer, who was under obligation to me, need not pay because I failed to co-operate with him."

In other words, can even the most liberal construction of an insurance policy in favor of an assured be carried so far as to permit him to say the words "collectible insurance available" give him the right and option to make that which was available when the accident happened, unavailable by his own act, leave it up to his own whim?

We strongly urge that to argue this constitutes a "reduction *ad absurdum*" of the rules of construction and that, therefore, the suggestion of Judge O'Connor in a memorandum which appellant quotes as the only authority should not and cannot, in justice and logic, be followed. It is submitted the conclusion reached by the Honorable James M. Carter is the only logical and reasonable and just one that the facts will support. If White chose to break Home's policy then he personally became liable up to a sum equal to the limits of insurance afforded him by the policy of Home, which far exceeded the judgment stipulated against him and for which this action is brought.

V.

The Appeal of North Umberland Was Not Filed in Time.

We have answered the appeal of North Umberland on the merits because we do not wish to appear in the least as avoiding the issue by making a technical argument.

Having done so, however, we feel it is our duty to call the Court's attention to the proceedings subsequent to the entry of judgment in connection with the extension of time to file the appeal. We entertain serious doubts that the appeal was taken in proper time and would feel remiss in our duty unless this point was called to the court's attention.

As appears from the summary of facts, the Notice of Appeal was not filed until an *ex parte* order was made on March 20 extending the time for the filing of such notice. It was based on an affidavit which Standard had no opportunity to contradict or into the truth of which it could not then inquire. Let us hasten to add that we do not insinuate at all that Mr. Armstrong's affidavit was not filed in good faith, but against his statement that he did not receive notice of entry stands the record of the docket that such notice was sent to him. The issue of fact thus created, we submit, should not have been resolved *ex parte* at a time when the original thirty days for filing the notice of appeal had long since expired.

We submit that the rules of civil procedure provide for *a motion* (see Rule 6(b)(2)), when the relief from the default or excusable neglect is sought after the expiration

of the time in which the act should have been originally performed. Had an application for extension of time been made before the expiration of the original thirty days, a "request" therefor under Rule 6(b)(1) would have been sufficient, but since it was made after the expiration of the original time, the only way in which relief could be obtained was *"upon motion"* as the rule expressly states. Where a motion is required a notice of such motion must likewise be given. Of course, the record clearly shows that no such notice was given. We have searched the Rules of Procedure and their interpretation but have been unable to find a case in which this issue is squarely decided. But we submit that an order based on an *ex parte* application is not sufficient to extend the time of appeal for any reason, where such application is made *after* the original 30 days for filing the notice of appeal have expired.

Conclusion.

In conclusion, therefore, we respectfully urge:

A. That this Honorable Court examine the question whether under Rule 6(b) an *ex parte* application and order to extend the time to appeal was sufficient, and determine that this appeal should be dismissed for lack of jurisdiction.

B. That in the event this Honorable Court should decide the foregoing question in the negative, holding that this appeal was instituted in time, it affirm the judgment of the District Court holding that there was "other valid

and collectible insurance available" to White; that since he made this insurance unavoidable by his own act, and since North Umberland has no greater rights than he, North Umberland was correctly and properly relegated to a position where it could collect only from White, and not from this appellee.

Respectfully submitted,

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JEAN WUNDERLICH,
Of Counsel.

No. 12950

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NORTH UMBERLAND MINING COMPANY, a Corporation,
Appellant,

vs.

STANDARD ACCIDENT INSURANCE COMPANY, a Corporation,
Appellee.

APPELLANT'S REPLY BRIEF.

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TABLE OF AUTHORITIES CITED

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APPELLANT'S REPLY BRIEF.

Restatement of the Case.

Appellee has gone so far afield in its argument and has raised and argued so many issues foreign to the case that it becomes necessary for appellant, *North Umberland Mining Company, not defendant, George White,* to restate the case.

In the first place, appellee, Standard Accident Insurance Company (hereinafter referred to as Standard), seems to forget that it was the primary insurance carrier of George White. By Standard's policy which White paid for and which Standard dictated the terms of, Standard insured White against loss occasioned by his driving

his Packard automobile or by his driving any other automobile while the Packard was being repaired. All of this coverage was primary insurance.

By way of exception and proviso (all according to the terms of Standard's policy dictated by Standard), this insurance by Standard became excess only if White while driving another automobile had available to him "other valid and collectible insurance." [Tr. p. 57, Last paragraph.] Such exceptions according to the courts of last resort of California must be strictly construed against Standard and liberally in favor of the assured and coverage.

Mahsee v. North American Accident Insurance Co., 190 Cal. 421, 213 Pac. 42;

Reed v. Pacific Indemnity Co., 101 A. C. A. 177, 225 P. 2d 255.

White at the time of the accident was driving a Lincoln Zephyr automobile, and its owner appellant, North Umberland Mining Company, had the automobile insured with Home against liability occasioned by injury or death to persons while the automobile was being driven by its agents or any other person driving the automobile with the owner's consent.

But the Home policy provided by way of conditions precedent that no action would lie against the company unless (1) the person driving the automobile cooperated with the company after the accident and (2) until the

amount of the company's obligation to pay should have been finally determined by final judgment or by written agreement between the insured, the company and the claimant. [Tr. p. 61, condition 6.]

The question is thus presented: when, according to the provisions of Standard's policy (an escape provision and exception), does Standard's insurance cease to become primary and become excess insurance and at what point of time according to the provisions of Home's policy does that insurance become *collectible* and available to White according to said escape provision and exception of Standard's policy.

We make bold to say that these precise questions have never been decided by any appellate court either national or state. Therefore, the questions necessarily must be decided upon an analysis of the terms and conditions of the policies themselves according to well settled and defined principles of construction and not as appellee seeks to do by applying general rules of law which give no consideration to the question as to when according to the conditions and provisions of particular insurance policies does the insurance become collectible insurance.

I.
ARGUMENT IN REPLY.

A. Preliminary Statement.

Standard concedes that the controlling question on this appeal is when, if ever, did the Home insurance become collectible insurance. (App. Rep. Br. p. 12.) We submit that it never did become collectible insurance because the conditions precedent of the policy were never met, and therefore the judgment of the District Court should be reversed. This because, as this Court said on the prior appeal:

> "Under the Civil Code of California, a condition precedent is given the same force as that indicated in the policy (Home's) that we are now considering. Section 1439 provides in part 'Before any party to an obligation can require another party to perform any act under it, he must fulfill all conditions precedent thereto imposed upon himself; * * *' * * * and if the insured cannot bring himself within the conditions of the policy he is not entitled to recover for the loss * * *." (167 F. 2d 919.)

If Home never became or could not become *obligated* under its policy to White, and he could not recover for the loss under it, how could the insurance ever become collectible within the meaning of the *exception* in Standard's policy?

To adopt the argument of appellee is to read into the policies of Standard and Home provisions which are not there and to rewrite both policies. This the law will not permit. (*Standard Accident Insurance Company v. Home Indemnity Company,* 167 F. 2d 919.)

B. The Home Insurance Never Became Collectible.

Appellee contends that North Umberland Mining Company is in no better position than White himself, and in support of that proposition cites three cases, all of which hold that an injured person is in no better position than the insured under an insurance policy. It is obvious that these cases do not have any application in a case where a party is seeking to enforce his rights of subrogation under the provisions of Section 402 of the California Vehicle Code.

Appellee next asserts that the primary insurance afforded to White by his policy with Standard became excess insurance at the exact moment of the accident. (App. Rep. Br. pp. 10 to 18.) In undertaking to maintain this assertion appellee studiously ignores, as it must, the provisions of the Standard and Home policies and particularly the conditions of the Home policy and the well established rules of construction relating to insurance contracts. Appellee does not, and cannot, cite any case or textbook which lays down any rule or principle establishing when automobile liability insurance becomes collectible under the provisions and conditions set out in the Home policy.

The best that can be said of appellee's argument is that appellee complains that White by failing to cooperate under the Home policy precluded North Umberland Mining Company from enforcing its rights of subrogation. The obvious answer to this position of appellee is that for this Court to adopt it, Standard's policy and Home's policy must be rewritten by this Court and terms and provisions be inserted that are not there. Such, of course, as this Court has said, the law will not do. The only

answer that appellee has to our application of the rules of construction laid down by the Appellate Courts of California is "this is not so." (App. Rep. Br. p. 20.)

Appellee maintains that the following cases lay down the principle that other collectible insurance becomes collectible at the time of the happening of the accident:

Travelers Indemnity Company v. State Auto Insurance Company, 66 Ohio App. 457, 37 N. E. 2d 198;

State Farm Mutual Auto Insurance Company v. Hall, 292 Ky. 22, 165 S. W. 2d 838;

Trinity Universal Insurance Company v. General Accident etc. Corporation, 138 Ohio St. 488, 35 N. E. 2d 836;

Zurich v. Clamor, 124 F. 2d 717;

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Maryland Casualty Co. v. Hubbard, 22 Fed. Supp. 697;

Lehigh Valley, etc. v. Providence, etc., 127 Fed. 364.

In none of these cases was the question presented or decided as to when "other collectible insurance" became collectible. Neither was there presented in any of these cases a policy containing any of the conditions precedent contained in the Home policy, nor were any such conditions considered.

In *Travelers Indemnity Company v. State Auto Insurance Company,* 66 Ohio App. 457, 37 N. E. 2d 198 (App. Rep. Br. p. 14), the controversy between the insurance companies arose after judgment against the driver of the automobile had been rendered. The only question for decision presented or decided was which of the carriers was the primary carrier. A similar situation was presented in *State Farm Mutual Auto Insurance Company v. Hall,* 292 Ky. 22, 165 S. W. 2d 838. (App. Rep. Br. p. 15.) The same may be said of *Trinity Universal Insurance Company v. General Accident etc. Corporation,* 138 Ohio St. 488, 35 N. E. 2d 836. (App. Rep. Br. p. 16.) In addition, the provision of the policy in that case was "other insurance" and not other collectible and other valid insurance. In *Air Transport v. Employers, etc.,* 91 Cal. App. 2d 129, 204 P. 2d 647, so strongly relied upon by appellee (App. Rep. Br. pp. 17 to 18), the sole question for decision was whether an insurance company could escape liability under its policy under a provision invalidating the insurance if the assured had "other valid insurance." The District Court of Appeal put the question for decision thus: "It is the contention of appellant that its policy never covered respondents because they had 'other valid insurance' which consisted of the Pacific Indemnity policy and that under clause 8 of appellant's policy the omnibus clause became void as to respondents."

The court in that case did not have before it a policy providing that the insurance would be excess insurance in the event there was "other collectible insurance" but merely "other valid insurance." The question was not presented, nor did the court decide when, "other collectible insurance" became collectible, nor did the court have

before it a policy containing conditions similar to those contained in the Home policy. What has just been said applies to the remaining cases cited by appellee.

C. The Appeal Was Filed in Time.

Appellee maintains that our application for extension to file notice of appeal was not properly ordered because it was made *ex parte*. Counsel can cite no cases in support of this proposition, and for that matter they cannot complain that they were not heard because they filed motion to vacate the order extending the time which was heard and argued by the Court and denied. [Tr. p. 47.] But apart from that, the rules of civil procedure for the District Court are to be liberally construed to promote the administration of justice and decisions are to be on the merits and not on procedural niceties. (Moore's Federal Practice, Second Ed., Sec. 1.13, pp. 55 to 56.)

Conclusion.

The judgment of the District Court should be reversed with directions because the judgment flies in the face of well settled rules of construction and the plain language of the policies under consideration.

To adopt the decision of the District Court would compel a rewriting of the policies and inserting provisions which are not found in the policies.

Respectfully submitted,

DONALD ARMSTRONG,

Attorney for Appellant.

No. 12951

United States
Court of Appeals
For the Ninth Circuit.

S. EINSTOSS,

Appellant,

vs.

JAMES V. COLE,

Appellee.

Transcript of Record

Appeal from the District Court for the Territory of Alaska
Division Number One

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

INDEX PAGE

NAMES AND ADDRESSES OF ATTORNEYS

M. E. MONAGLE,

200 Seward Bldg.,
Juneau, Alaska.

For the Plaintiff.

WILLIAM L. PAUL, JR.,

208 Franklin St.,
Juneau, Alaska.

For the Defendant.

In the District Court for the Territory of Alaska, Division Number One, at Juneau

Civil Action, File No. 6184-A

JAMES V. COLE,

Plaintiff,

vs.

SAM ASP and MAUDE ASP, Copartners, Doing Business Under Their Copartnership Trade Name of SALT SEA FISHERIES,

Defendants.

COMPLAINT

The plaintiff above named complains of the defendant and for cause of action alleges:

1. That the plaintiff is an individual, resident of Juneau, Alaska, and the defendants are copartners doing business under their copartnership trade name of Salt Sea Fisheries in Tenakee, Alaska, and within the jurisdiction of this Court.

2. That defendant owes the plaintiff the sum of Nine Hundred Twenty Seven and no/100 ($927.00) Dollars for boat charter and skid pile driver rental for the period ending November 1, 1948, which amount defendant agreed to pay, but which has not been paid by defendants to plaintiff.

3. That plaintiff has been obliged to employ an attorney to institute and prosecute this action and that $250.00 is a reasonable sum to allow plaintiff as and for attorney's fees.

Wherefore, plaintiff demands Judgment against

defendant in the sum of $927.00, together with interest thereon at the rate of six per cent per annum from November 1, 1948 until paid, and for plaintiffs' costs and disbursements, including the sum of $250.00 as and for attorney's fees.

/s/ M. E. MONAGLE,
Attorney for Plaintiff.

United States of America,
Territory of Alaska—ss.

James V. Cole, being first duly sworn, on oath, deposes and says: That I am the plaintiff in the above and foregoing action and have read said Complaint and know the contents thereof and that the same is true and correct as I verily believe.

/s/ JAMES V. COLE

Subscribed and Sworn to before me this 3rd day of October, 1949.

[Seal] M. E. MONAGLE,
Notary Public for Alaska.

My commission expires March 1, 1950.

[Endorsed]: Filed October 3, 1949.

[Title of District Court and Cause.]

WRIT OF ATTACHMENT

To the Marshal of the Territory of Alaska, Division No. 1, or to his deputy, Greeting:

Whereas, James V. Cole hath complained that

Sam Asp and Maude Asp, copartners, doing business under their copartnership trade name of Salt Sea Fisheries, are justly indebted to him to the amount of Nine Hundred Twenty Seven and no/100 ($927.00) Dollars, and the necessary affidavit and undertaking herein having been filed as required by law.

We, Therefore Command You That you attach and safely keep so much of the property of said defendants not exempt from execution, or so much as may be sufficient to satisfy the plaintiff's demand, to be found in your Division of said Territory, as shall be of value sufficient to satisfy the said debt and the costs and disbursements of the said plaintiff herein, and of this writ make due service and return.

Witness, the Honorable George W. Folta, Judge of said District Court, and the seal thereof affixed at Juneau in said Territory, this 3rd day of October, 1949.

J. W. LEIVERS,
Clerk,

[Seal] By /s/ LOIS P. ESTEPP,
Deputy Clerk.

United States of America,
Territory of Alaska,
Division Number One—ss.

I hereby certify and return that I received the within and hereto writ of attachment at Juneau, Alaska, on the 3rd day of October, 1949 and that the same was served on October 3, 1949, at Juneau,

Alaska, by delivering to and leaving with Sam Asp a certified copy of the within writ and at the same time informing said Sam Asp that 85 cases of canned salmon at Tenakee, Alaska, was thereby attached and held in the possession of the United States Marshal;

I further certify that on October 5, 1949, at Juneau, Alaska, a certifieid copy of the within writ was served by delivering to and leaving with Cleo Commers, in charge of the Dock known as the Juneau Municipal Dock, and 100 cases of canned salmon belonging to the defendant were attached;

I further certify that on October 5, 1949, at Tenakee, Alaska, I delivered to and left with Mrs. Sam Asp a certified copy of the within writ, and attached 85 cases of canned salmon and posted on same a Notice of Attachment, at Tenakee, Alaska.

Dated at Juneau, Alaska, October 5, 1949.

WILLIAM T. MAHONEY,
U. S. Marshal.

By /s/ WALTER G. HELLAN,
Deputy.

Marshal's fees $6.20.

[Endorsed]: Filed October 3, 1949.

[Title of District Court and Cause.]

MOTION TO QUASH SERVICE OF WRIT

Comes now S. Einstoss, garnishee-defendant in the above-entitled cause, and moves Court for an order quashing the levy of writ of attachment in this cause made by the United States Marshal at Tenakee, Alaska, on October 5, 1949, on eighty-five (85) cases of Coho Salmon: and for grounds, states that said salmon was then the property of movant and the defendant, above-entitled, has no interest therein.

/s/ WILLIAM L. PAUL, JR.,
Attorney for S. Einstoss,
Garnishee-defendant.

Copy received October 20, 1949.

/s/ M. E. MONAGLE,
Attorney for plaintiff.

[Pencil note: Denied in effect 11/14/49.]

[Endorsed]: Filed October 22, 1949.

DEFENDANT'S EXHIBIT A

In the District Court for the Territory of Alaska
Division Number One, at Juneau

No. 6184-A

JAMES V. COLE,

Plaintiff,

vs.

SAM ASP, etc.,

Defendant.

United States of America,
Territory of Alaska—ss.

K. William Oakson, being first duly sworn, on oath depose and say that I am agent for S. Einstoss and am duly authorized by him to make affidavits and claims of this nature on his behalf; that in the above-entitled action, by virtue of a writ of attachment issued by the above-entitled court, the U. S. Marshal on the 5th day of October, 1949, levied on 85 cases of 48 one pound cases each of silver or coho salmon in the warehouse of the defendant Sam Asp at Tenakee, Alaska; that said salmon has always been and now is the property of S. Einstoss and he is entitled to the immediate possession thereof; that during the fishing season of 1949, the defendant Sam Asp has been employed by S. Einstoss to can said salmon and such other salmon as said Einstoss delivered to the said Asp, that for such labor the said Asp received the actual cost of packing said salmon, that the said Einstoss has always been the owner of said 85 cases of salmon,

including the fish, cans, cases; that prior to the time of said levy of writ of attachment, all accounts between the said Einstoss and defendant Asp were and still are settled and for said 85 cases of salmon, the said Einstoss owes the said Asp nothing.

Affiant on behalf of his principal herewith demands the immediate release of said 85 cases of salmon from the levy of said writ of attachment.

/s/ K. WILLIAM OAKSON.

Subscribed and sworn to before me this October 14, 1949.

[Seal] By /s/ WILLIAM L. PAUL, JR.,
Notary Public for Alaska.

My Commission expires January 19, 1952.

[Endorsed]: Filed November 10, 1949.

[Title of District Court and Cause.]

MOTION FOR SUMMARY JUDGMENT

Comes now S. Einstoss, Garnishee-defendant in this case, and moves for summary judgment in his favor that the eighty-five (85) cases of salmon, heretofore taken under attachment in this case at Tenakee, Alaska, be released and said levy quashed and for grounds refers to the affidavit and ex-

hibits attached hereto as well as other matters of record.

/s/ WILLIAM L. PAUL, JR.,
Garnishee-defendant's
Attorney.

Copy Received April 17th, 1950.

/s/ M. E. MONAGLE,
Plaintiff's Attorney.

[Title of District Court and Cause.]

AFFIDAVIT OF S. EINSTOSS ON MOTION TO QUASH LEVY OF WRIT OF ATTACHMENT ON EIGHTY-FIVE CASES OF SALMON

United States of America,
Territory of Alaska—ss.

S. Einstoss, being first duly sworn, on oath deposes and says that he is the Garnishee-defendant and third party claimant with relation to his motion to quash levy of writ of attachment on 85 cases of salmon at Tenakee, Alaska, on or about October 5, 1949, by the United States Marshal in this case.

That at the time of said levy, said salmon was worth, at the Seattle wholesale rate, $16.75, and therefore was worth at Tenakee, Alaska, at the time of said levy $15.75.

That during the Summer of 1949, affiant conducted a fish operation business in Southeastern

Alaska, part of which was the following arrangement: S. Einstoss and defendants entered into a contract, partly oral and partly written, by the terms of which affiant agreed to furnish fish, boxes, labels and all other materials necessary for the canning and preparing of salmon for transportation to defendants, and defendants agreed to can said salmon in the usual manner and prepare the same for shipment by means of using the supplies, materials and goods furnished by affiant. This oral contract was made on or about the 12th day of August, 1949, at Ketchikan, Alaska, and the written portions of said contract are evidenced in letters between affiant and defendants, some of which letters are attached hereto and made a part hereof by reference and marked "Exhibit——."

For the supervision of said contract and for the furnishing of said supplies and materials, affiant employed William Oakson, who has heretofore made and filed his affidavit, on my behalf, for the release of said salmon. That the said Oakson was duly authorized by me to make such claim on my behalf, having obtained such authorization shortly after the said levy by means of a long distance telephone conversation with me from Juneau to Ketchikan.

The said contract between me and defendants was also that the defendants were to have available at all times during the various salmon seasons of 1949, their plant at Tenakee, Alaska. That the said 85 cases of salmon were canned by defendants out of fish supplied by me and using materials such as cases, cans and salt supplied by me. That defend-

ants did not conduct any fish purchasing business of their own from which any salmon could have been canned and result in the said 85 cases of salmon.

That as part of said contract to can salmon for affiant, affiant agreed to pay the said defendants the sum of $3.50 per case for furnishing labor, cans and services in the canning of said salmon. This sum is approximately standard rate in Southeastern Alaska for services performed. Said payment of $3.50 per case does not include the furnishing by defendants of any materials or other things which are presently or have ever been in, on, or about said 85 cases of salmon, but consisted only of defendants furnishing labor, services and plant by which and in which to can said salmon.

On or about the 18th day of August, 1949, the affiant and defendants settled their accounts and affiant paid in full the defendants for any and all services performed under said contract for 1949, which settlement included payment to defendants, under said contract, for the canning of said 85 cases of salmon, and thereafter found that 972 cases of salmon had to be reconditioned at a rate of $2.00 per case, in the amount of $1,944.00, and after same were reconditioned, 278 cases were found not suitable for human consumption and therefore had to be destroyed. Therefore, under our agreement, Sam Asp had to repay me the above loss, but never did.

Affiant now owns and has always owned said 85 cases of salmon.

/s/ S. EINSTOSS

Subscribed and sworn to before me this 11th day of April, 1950.

[Seal] /s/ K. M. DOUGHERTY,
Notary Public in and for the
State of Washington.

My commission expires 7-8-52.

Cash Advanced to Asp

Cash	$2,904.00
Wages paid in full	2,864.82
Advances	934.00
Groceries	124.70
Rent for Benny, Virgil et al	12.00
Freight on salt from Sup. Pkg. Co.	8.00
Gloves	50.70
Cash to Sam Asp	80.00
Taxi	6.00
Hotel	5.65
Alaska Coastal Airline charter	37.80
Alaska Coastal Airline charter	10.34
Cash to Maud Asp	100.00
Airplane to Ketchikan	77.50
School Tax for Maud Asp	5.00
Wages for some Mexican paid by Boat Wilson	3.00
Wharfage and freight on salt	11.00
Wharfage and freight on salt	8.00

Check to Mr. Kemp for pipeline	150.00
Advance to Sam Asp	150.00
Airline ticket to Ketchikan	84.00
Hotel	12.00
Harry Race Druggist (check)	36.99
California Grocery	173.23
Special Longshoring for Danny and others	10.00
Longshoring on Cape Spencer	101.75
Longshoring on Forester	64.75
	$8,064.46
	$7,897.96

O. K.

SAM ASP,
By MAUD ASP
Also MAUD ASP

Mr. S. Einstoss
Ketchikan, Alaska

Dear Mr. Einstoss:

In accordance with our conversation we offer to pack for you canned salmon at our cannery at Tenakee, Alaska on the following terms and conditions:

We are to furnish all labor, oil for the cannery and cans.

We are to buy the fish for you at the going prices or prices authorized by you, and for the above services you are to pay us $3.50 per case for packing salmon in tall cans of 48 cans to a case.

We agree to pay for your account exclusively

during the season of 1949. Any increase in the going price of fish must be authorized by you in writing only.

All expenses pertaining to chartering tenders, wages for the tenders is for your account.

You are to furnish money to pay for the fish. Also advance the money for the cans and freight.

We guarantee that we will pack fish that will pass the National Canners inspection.

On the other hand we reserve the right to reject any fish that is not suitable for canning.

Payment to us to be made is as follows:

You are to put a man in charge and he is to pay for the fish and tenders. He is also to pay for the cannery labor and oil used in the cannery as an advance to us as payment on account. The above payments to be made in accordance with our instructions for which we will give him a receipt. You also to advance for the cans and freight for the cans. You will pay the balance of $3.50 as soon as the fish is shipped and passes the National Canners inspection. Should the National Canners find any salmon packed by ourselves not suitable for human consumption you have the right to charge us with the amount of the cost of same.

Further, it is understood and agreed that in addition to the above mentioned advances, you are to pay us if any money is due about the time the fish is shipped with the exception of 50 cents per case until the fish passes the National Canners inspection as above mentioned.

Your acceptance of the above constitutes a contract.

Your truly,

/s/ SAM ASP,

/s/ MAUDE ASP.

[Endorsed]: Filed April 19, 1950.

[Title of District Court and Cause.]

AFFIDAVIT OF M. E. MONAGLE

United States of America,
Territory of Alaska—ss.

M. E. Monagle, being first duly sworn, on oath, deposes and says: That heretofore and on October 22, 1949, S. Einstoss made and filed his Motion that the levy of the Writ of Attachment on 85 cases of salmon be quashed and said Motion was duly and regularly argued by attorneys for plaintiff and S. Einstoss before this Court on November 10, 1949, at which time this Court denied a Motion of S. Einstoss and to the best recollection of deponent stated that the question of the ownership of the attached salmon would be decided upon the evidence offered upon the trial of this case on its merits; that as a consequence of this Court's ruling plaintiff has not previously made any effort to obtain the testimony of S. Einstoss; that for all practical purposes the Motion of S. Einstoss for a Summary Judgment is exactly the same as his Motion that the Writ of

Attachment be quashed; that as soon as a Motion for Summary Judgment of S. Einstoss was served upon plaintiff's attorney on April 17, 1950, your deponent has been making a concerted effort to learn the present whereabouts of S. Einstoss in order to serve him with a subpoena, in order to have him present for the purpose of giving testimony when the Motion for Summary Judgment came on for hearing, but your deponent was unable to ascertain the whereabouts of said Einstoss until approximately 2:45 o'clock P.M. on May 1, 1950, at which time your deponent was reliably informed that S. Einstoss was in San Francisco, California, but would be in Ketchikan, Alaska, on or about May 15, 1950; that a subpoena has been issued out of and under the seal of this Court directed to S. Einstoss and requiring him to appear before this Court with his books and records on May 18th, 1950; that the plaintiff in this case cannot hope to successfully defeat the Motion for a Summary Judgment without the presence of S. Einstoss and his books and records; therefore, deponent prays that this Court either sustain its ruling that the question of the ownership of the 85 cases of salmon be disposed of at the time of the trial of this case on its merits, and refuse the application for Judgment, or in the alternative order a continuance of the hearing on said Motion to a day certain after May 15, 1950, so that the subpoena issued out of this Court in this case may be served upon S. Einstoss and he and his books and records are present in this Court for examination by plaintiff.

/s/ M. E. MONAGLE.

Subscribed and Sworn to before me this 2nd day of May, 1950.

[Seal] /s/ FREDERICK O. EASTAUGH,
Notary Public for Alaska.

My commission expires June 10, 1950.

[Endorsed]: Filed May 3, 1950.

[Title of District Court and Cause.]

MOTION FOR CONTINUANCE OF HEARING ON THE MOTION OF S. EINSTOSS FOR SUMMARY JUDGMENT

Comes now plaintiff James V. Cole by his attorney and moves that this Court refuse the application of S. Einstoss for a Summary Judgment, or in the alternative that this Court grant a continuance to permit plaintiff to obtain the presence in Court of third party claimant, S. Einstoss, on the grounds that the material question involved was decided by this Court on November 10, 1949, on the Motion of third party claimant S. Einstoss to quash the Writ of Attachment herein; and, on the further grounds that the testimony of S. Einstoss is necessary for the presentation of plaintiff's essential facts in opposition to the Motion for a Summary Judgment, and plaintiff has been unable to serve S. Einstoss with a subpoena.

This Motion is based upon the records and files

of this case and upon the affidavit of M. E. Monagle hereto attached.

Respectfully submitted,

/s/ M. E. MONAGLE,
Attorney for Plaintiff.

Receipt of Copy acknowledged.

[Endorsed]: Filed May 3, 1950.

In the United States District Court
For the Territory of Alaska, Division Number One

United States of America,
Territory of Alaska—ss.

SUBPOENA

The President of the United States of America,

To: S. Einstoss, Greeting:

You Are Hereby Commanded to appear before the District Court of the United States, for the Territory of Alaska, at Juneau, Alaska, in said District, on Monday, the 26th day of June, 1950, at 10:00 o'clock A.M. of that day, to testify as a witness on behalf of the plaintiff in the case of James V. Cole vs. Sam Asp and Maude Asp, copartners, doing business under their co-partnership trade name of Salt Sea Fisheries, and bring with you all books, papers and records with reference to your personal business transactions with Sam Asp and Maude Asp, individually or as co-partners doing

business under their co-partnership trade name of Salt Sea Fisheries, including all fish purchase and sales slips for the year 1949, all telegrams, letters and communications, or copies thereof, passing between you and either Sam Asp personally or Maude Asp personally, or Sam Asp and Maude Asp, co-partners doing business under their co-partnership trade name of Salt Sea Fisheries, and between you and K. W. Oakson, all payroll and tax records for the year 1949, all canceled checks for the year 1949, all shipping receipts and copies of bills of lading, way-bills and freight bills for the year 1949, and the original and all copies of any and all agreements entered into between you individully and Sam Asp individually and Maude Asp individually and Sam Asp and Maude Asp, co-partners doing business under their co-partnership trade name of Salt Sea Fisheries, and depart not the Court without leave thereof or of plaintiff's attorney. Hereof fail not.

Witness the Honorable George W. Folta, Judge of said Court, and the Seal thereof, affixed at Juneau, in said Territory, this 9th day of June, 1950.

J. W. LEIVERS,
Clerk of the District Court.

[Seal] By /s/ LOIS P. QUILICO,
Deputy.

United States of America,
Territory of Alaska,
Division Number One—ss.

I hereby certify and return that I received the within and hereto Duces Tecum Subpoena at Juneau, Alaska on the 9th day of June, 1950 and that I served the same at Juneau, Alaska, on the 25th day of June, 1950 by delivering to and leaving with S. Einstoss a certified copy of the within Duces Tecum Subpoena, personally and in person, and that I did at the same time deliver to and leave with said S. Einstoss the sum of $3.00 in cash as a witness fee.

Dated at Juneau, Alaska, June 26, 1950.

WILLIAM T. MAHONEY,
U. S. Marshal.

By /s/ WALTER G. HELLAN,
Deputy.

Marshal's fees .85.

[Endorsed]: Filed June 26, 1950.

In the United States District Court
For the Territory of Alaska, Division Number One

United States of America,
Territory of Alaska—ss.

SUBPOENA

The President of the United States of America,

To: S. Einstoss, Greeting:

You Are Hereby Ordered to appear before the District Court of the United States, for the Territory of Alaska, at Juneau, Alaska, in said District, on Wednesday, the 20th day of September, 1950, at 10:00 o'clock A. M. of that day, to testify as a witness on behalf of the plaintiff in the case of James V. Cole vs. Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, and bring with you all books, papers and records with reference to your personal business transactions with Sam Asp and Maude Asp, individually or as co-partners doing business under their co-partnership trade name of Salt Sea Fisheries, including all fish purchase and sales slips for the year 1949, all telegrams, letters and communications, or copies thereof, passing between you and either Sam Asp personally or Maude Asp personally, or Sam Asp and Maude Asp, co-partners doing business under their co-partnership trade name of Salt Sea Fisheries, and between you and K. W. Oakson, all payroll and tax records for the year 1949, all cancelled checks

for the year 1949, all shipping receipts and copies of bills of lading, way-bills and freight bills for the year 1949, and the original and all copies of any and all agreements entered into between you individually and Sam Asp individually and Maude Asp individually and Sam Asp and Maude Asp, co-partners doing business under their co-partnership trade name of Salt Sea Fisheries, and depart not the Court without leave thereof or of plaintiff's attorney. Hereof fail not.

Witness the Honorable George W. Folta, Judge of said Court, and the Seal thereof, affixed at Juneau, in said Territory this 29th day of June, 1950.

J. W. LEIVERS,
Clerk of the District Court,

[Seal] By /s/ LOIS P. QUILICO,
Deputy.

United States of America,
Territory of Alaska,
Division Number One—ss.

I hereby certify that I received the within and hereto Subpoena at Juneau, Alaska on the 29th day of June, 1950, and that I served the same at Juneau, Alaska, on the 29th day of June, 1950, by delivering to and leaving with S. Einstoss a certified copy of the within subpoena, together with a witness fee in the sum of $3.00 personally and in person.

Dated at Juneau, Alaska, June 29, 1950.

WILLIAM T. MAHONEY,
U. S. Marshal.

By /s/ WALTER G. HELLAN,
Deputy.

Marshal's fees .85.

[Endorsed]: Filed July 5, 1950.

[Title of Cause.]

MINUTE ORDERS

Minute Order of the District Court dated November 14, 1949 as recorded on Page 319 of Journal #19.

This matter having heretofore come before the court and arguments having heard on defendant's Motion to Quash Service of Writ, the court at this time, in effect, denied the same by the following. "The Court will not decide the question of ownership on affidavits or testimony of one witness. Claimant should intervene so that all available evidence on question of ownership (of salmon) may be presented.

Minute Order of the District Court dated May 5, 1950 as recorded on Page 429 of Journal #19.

This case came before the court for hearing of arguments on plaintiff's Motion for Summary Judgment. William L. Paul, Jr., appeared for plaintiff and M. E. Monagle for defendant. After arguments

of counsel, the court denied the motion. This case having been set for trial on Thursday, May 11th, after discussion between court and counsel, it was moved up and set for trial to follow No. 6032-A which is set for May 18th.

Minute Order of the District Court dated May 18, 1950, as recorded on Page 443 of Journal #19.

This matter having been set for trial at this time M. E. Monagle was present for plaintiff and William L. Paul, Jr., was present for defendants. Attorney for plaintiff stated that one of his witnesses had not arrived and thereafter both parties stipulated that this matter be continued. The court thereupon set this matter for trial Monday, May 22nd, to follow #6222-A Panis vs. Vosotros.

Minute Order of the District Court dated May 22, 1950, as recorded on Page 448 of Journal #19.

This case having been set for this date Mr. Monagle attorney for plaintiff informed the court that the Marshal was unable to serve subpoena for a witness necessary in order to try this case. Thereupon by agreement with William L. Paul, Jr., attorney for defendants the court definitely set this case for trial at 10 A. M. June 8th.

Minute Order of the District Court dated June 9, 1950, as recorded on Page 457 of Journal #19.

At this time the Court re-set this case for trial on June 26th at 10 A.M.

Minute Order of the District Court dated June 29, 1950 as recorded on Page 466 of Journal #19.

This case having been set for trial to follow

#6290-A the parties asked that this case be postponed until September 20th, which the court allowed.

Minute Order of the District Court dated September 20, 1950, as recorded on Page 13 of Journal #20.

This case came before the court for hearing on the claim of S. Einstoss. Plaintiff was not personally present, but was represented by M. E. Monagle. Defendants were in default and were therefore not represented. The third party, S. Einstoss was present by virtue of a Subpoena Duces Tecum and was represented by William L. Paul, Jr. Mr. Monagle advised the court that the witness Einstoss was an adverse witness; witness Einstoss was duly sworn. A letter, undated, written to S. Einstoss by Sam and Maude Asp was admitted in evidence as plaintiff's Exhibit #1. Demand for the books of Einstoss was made by Mr. Monagle, but all the witness could produce was papers and reports given the said Einstoss by his bookkeeper. After discussion, the court continued the hearing on this matter over till Einstoss could appear in court with his books and his bookkeeper and the court further decreed that Einstoss would be assessed with all costs incurred by virute of the continuance.

Minute Order of the District Court dated December 29, 1950, as recorded on Page 63 of Journal #20.

Upon the calling of the trial calendar of cases for trial, the court set this case for trial on January 5, 1951 at 10 A.M.

Minute Order of the District Court dated January 5, 1951, as recorded on Page 72 of Journal #20.

This case was set for trial at this time. William L. Paul, Jr., appeared in behalf of S. Einstoss, Garnishee Defendant; M. E. Monagle was present for plaintiff. Mr. Paul moved for a continuance; Mr. Monagle objected, complaining of delay and called attention to the 100 cases of salmon under attachment and in storage with costs piling up. After discussion the court denied the motion. Mr. Paul then moved for an order directing the Clerk to deliver certain papers and records on deposit with the court so that an accounting report can be completed. After discussion this was denied and the Court ordered that Mr. Einstoss appear in court with his books of record, and with and account or someone who understands them, and he was given until January 22nd to comply, and in the meantime all costs of delay would be assessed against the garnishee defendant.

Minute Order of the District Court dated January 23, 1951, as recorded on Pages 90 and 91 of Journal #20.

This case came before the court for further hearing on its trial, the same having been continued over from September 20, 1950. William L. Paul Jr., was present for S. Einstoss, third party claimant. M. E. Monagle appeared for plaintiff. Robert L. Ramsey was called and sworn for testimony in behalf of S. Einstoss. After his testimony was completed and court and counsel had discussed the matter at length, this case was recessed till 2 P.M.

to give counsel an opportunity to agree on certain facts.

At this time with both counsel of record present, Mr. Monagle advised the Court that he had gone over the material submitted by S. Einstoss with the witness Robert L. Ramsey and that apparently the summary prepared by this witness and sought to be admitted in evidence was made up from the said material and not from the "books" submitted; he would not admit that the summary was correct, but that it was most unsatisfactory. The matter was discussed at length between court and counsel after which the court decreed that S. Einstoss had failed to prove ownership of some 86 cases of canned salmon under attachment herein.

[Title of District Court and Cause.]

COST BILL

Statement of disbursements claimed in the above entitled cause, viz.:

Clerk's Fees	$ 15.00
Marshal's Fees	30.15
Trial Fee	6.00
Attorney's Fees	250.00
Disbursements Storage of fish	186.01
Witness Fees S. Einstoss	12.00
James V. Cole	12.00
Total	$511.16

United States of America,
Territory of Alaska,
Division No. 1—ss.

I, M. E. Monahgle, being duly sworn, say I am the Attorney for Plaintihff in the above-entitled cause; that the costs and disbursements set forth above have been necessarily incurred in the prosecution of this suit, and that Plaintiff is entitled to recover the same from the Defendants and Garnishee-Defendant.

/s/ M. E. MONAGLE.

Subscribed and sworn to before me this 26th day of January, 1951.

[Seal] /s/ J. W. LEIVERS,
Clerk

Costs taxed at $511.16 this .... day of January, 1951.

Receipt of Copy acknowledged.

[Endorsed]: Filed, January 26, 1951.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This matter having come regularly on for trial in open Court, without a jury, the plaintiff appearing by his attorney M. E. Monagle, and the defendants having appeared herein by their attorney William L. Paul, Jr., and the garnishee defendant ap-

pearing by his attorney William L. Paul, Jr., and it appearing to the Court that this case was filed and docketed in this Court on October 3, 1949, and thereafter a Summons was duly issued out of and under the seal of this Court, which Summons was personally served upon the defendants by the United States Marshal for the First Judicial Division of the Territory of Alaska, at Juneau, Alaska, on October 3, 1949, and within the jurisdiction of this Court, and thereafter defendants appeared hearin and filed their Answer to plaintiff's Complaint, and plaintiff thereafter filed his Reply to defendant's Answer; and, that thereafter and on May 2, 1950, William L. Paul Jr., made and filed herein his Motion for permission to withdraw as attorney for defendants Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, and thereafter and on the same day the above-entitled Court made its Order granting the Motion of William L. Paul, Jr., and permitting him to withdraw as attorney for said defendants and directed the Clerk of the above-entitled Court to notify said defendants that this case was set for trial and was to be tried on Thursday, May 4, 1940, and directing that defendants obtain another attorney to represent them if they desired to do so; and, that thereafter and on May 4, 1950, this case was reset for trial to take place on May 18, 1950; and thereafter and on May 18, 1950; this case was reset for trial on May 22, 1950; and, it appearing that thereafter and on May 22, 1950, at the request of William L. Paul, Jr., the

trial date was reset for June 8, 1950, and thereafter, and on the Motion of William L. Paul, Jr., the case was again reset for trial on June 26, 1950, and that thereafter and on June 29, 1950, the case was reset for trial on September 20, 1950; and, it further appearing that thereafter and on September 20, 1950, this case came regularly on for trial and plaintiff appeared personally and by his attorney M. E. Monagle, and the defendants Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, failed to appear or adduce any evidence whatsoever on their behalf, and the garnishee defendant S. Einstoss appeared personally and by his attorney William L. Paul, Jr., and adduced evidence in support of his contention that he was the owner of 85 cases containing 48 one pound cans each of silver or cohoe salmon per case, which had been attached and seized by the United States Marshal on October 5, 1949, by virtue of a Writ of Attachment levied upon said cases of salmon in the warehouse of defendant Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, at Tenakee, Alaska, and in support of his contention that said defendants were not the owners of said salmon; and, it appearing that said S. Einstoss had failed to produce his books and records as required by the subpoena directed to him and issued out of this Court, under the seal of this Court, on June 29, 1950; thereupon, at the request of said S. Einstoss and his attorney William L. Paul, Jr., the trial was

thereupon continued over until said garnishee defendant S. Einstoss could appear and produce his books and records, which Order continuing the date of the trial to December 29, 1950, was made on the condition that S. Einstoss would pay all costs, and that all costs incurred by virtue of the continuance of the trial of this case would be assessed against said garnishee defendant S. Einstoss; and, it further appearing that the trial of this case came before the Court again on December 29, 1950, at which time plaintiff appeared personally and by his attorney M. E. Monagle, and the defendants again failed to appear or adduce any evidence in their behalf, and the garnishee defendant S. Einstoss failed to appear and adduce any evidence in his behalf, and at the request of William L. Paul, Jr., attorney for S. Einstoss, this Court again continued the trial at the request of William L. Paul, Jr., attorney for S. Einstoss, to January 22, 1951, in order to give said garnishee defendant S. Einstoss an opportunity to produce his books and records, which Order provided that all costs incurred by virtue of said continuance would be assessed against said garnishee defendant S. Einstoss; and, this case having come regularly on for trial in open Court as hereinabove specified on January 23, 1951; and, it further appearing that by virtue of a Writ of Attachment issued out of this Court the United States Marshal levied upon, seized and took into his possession on October 5, 1949, and now holds and has in his possession by virtue of and under the lien of said attachment, 100 cases of pink salmon which have

not been sold as perishable property or discharged from said attachment or the lien thereof as provided by law, or otherwise, and are now held by virtue of and under the lien of said attachment; and, the Court being now fully advised in the premises makes and enters its Findings of Fact and Conclusions of Law, as follows:

Findings of Fact

I.

That the defendants Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, are co-partners doing business under their co-partnership trade name in Tenakee, Alaska, and within the jurisdiction of this Court, and plaintiff is an individual resident of Juneau, Alaska.

II.

That said defendants Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, owe plaintiff James V. Cole the sum of $927.00 for boat charter and skid pile driver rental for the period ending November 1, 1948, which amount said defendants agreed to pay, but which has not been paid by defendants to plaintiff.

III.

That a Writ of Attachment was heretofore and on October 3, 1949, duly and regularly issued out of and under the seal of this Court, directing the United States Marshal to attach and safely keep

as much of the property of said defendants as might be sufficient to satisfy the plaintiff's demands and the costs and disbursements of plaintiff herein, and that by virtue of and under the authority of said Writ of Attachment the said United States Marshal for the First Judicial Division of Alaska, thereafter and on October 5, 1949, duly and regularly levied upon, attached and now holds and has in his possession by virtue of and under the lien of said attachment, one hundred cases of pink salmon which was placed in storage and is still in storage at the city dock in Juneau, Alaska, and which one hundred cases of pink salmon have not been sold as perishable property or discharged from said attachment or the lien thereof as provided by law, or otherwise, and are now held by virtue of and under the lien of said attachment pending the Judgement of this Court.

IV.

That a Writ of Attachment was heretofore and on October 3rd, 1949, duly and regularly issued out of and under the seal of this Court, directing the United States Marshal to attach and safely keep so much of the property of the defendants as might be sufficient to satisfy the plaintiff's demands and the costs and disbursements of plaintiff herein, and that by virtue of and under the authority of said Writ of Attachment the United States Marshal for the First Judicial Division of Alaska duly and regularly attached eighty-five cases of silver salmon containing forty-eight one pound cans per case, and thereafter and on October 14, 1949, the garnishee

defendant S. Einstoss made his claim of ownership of said eighty-five cases of silver salmon and thereafter and on October 17, 1949, made and gave the United States Marshal a written Undertaking, executed by K. O. Oakson, agent for said claimant S. Einstoss, as principal, and Wallis S. George and Mrs. G. R. Kennedy as sureties, wherein and whereby they covenanted and agreed to undertake in the sum of $1,530.00, being the amount for that purpose fixed by the custodian as the value of said attached salmon, at Tenakee, Alaska, and undertook and agreed that they would pay any Judgment against the said garnishee defendant S. Einstoss by redelivering said attached salmon, or the value thereof, to the said United States Marshal as an executive officer of this Court, and thereupon the United States Marshal surrendered said eighty-five cases of salmon to said S. Einstoss; and, that said eighty-five cases of forty-eight one pound cans to the case of silver salmon has not been sold as perishable property or discharged from said attachment or the lien thereof as provided by law, or otherwise.

V.

That plaintiff James V. Cole, as an attachment creditor, is a purchaser in good faith and for a valuable consideration of the property so attached in this case by the United States Marshal as hereinabove stated in these Findings, and the garnishee defendant S. Einstross has failed to prove ownership, and is hereby found not to be the owner of said eighty-five cases of forty-eight one pound cans per case of silver salmon claimed by him.

Conclusions of Law

I.

That James V. Cole, the plaintiff herein, is entitled to Judgment against the defendants Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, for the sum of $927.00, together with interest thereon at the rate of 6% per annum from November 1, 1948, amounting to $124.00, making a total Judgment in favor of plaintiff and against defendants in the sum of $1,051.00, together with interest thereon from the date hereof until paid at the rate of 6% per annum, together with plaintiff's costs and disbursements herein incurred, including the sum of $250.00 as and for attorney's fees.

II.

That the personal property, consisting of one hundred cases of salmon containing forty-eight one-pound cans of salmon in each case, and said eighty-five cases of silver salmon containing forty-eight one-pound cans of salmon in each case, levied upon and now held by virtue of a Writ of Attachment in the hands of the United States Marshall as hereinabove described and specified, should not be sold as perishable property or discharged from the attachment as provided by law, but plaintiff is entitled to have an Order entered herein ordering and adjudging that all of the aforesaid attached property be sold to satisfy plaintiff's said Judgment and to have execution issue herein for the satisfaction of said Judgment, and to have the

United States Marshal apply the said property so attached by him, and the proceeds derived therefrom by the sale thereof under execution, to satisfy plaintiff's said Judgment, including costs of sale, accruing costs, and costs and attorney's fees, and to have execution for any deficiency which may remain, but the excess, if any, should upon demand be paid to the defendants.

III.

That plaintiff should have Judgment against the garnishee defendant S. Einstoss and Wallis S. George as surety on his Undertaking heretofore made and filed herein and against Mrs. G. R. Kennedy as surety on his bond and Undertaking heretofore made and filed herein; that said S. Einstoss immediately and forthwith redeliver said eighty-five cases of silver salmon containing forty-eight one-pound cans per case, to the United States Marshal or pay the sum of $1,530.00, which is the value of those certain eighty-five cases of forty-eight one-pound cans each of silver salmon heretofore attached by the United States Marshal as in these Findings and Conclusions above specified, which salmon was surrendered to the defendant S. Einstoss on his claim of ownership, upon his making and filing his said Undertaking for delivery with Wallis S. George and Mrs. G. R. Kennedy as sureties on said Undertaking for delivery, or so much of said $1,530.00 as may be necessary to satisfy plaintiff's Judgment, together with principal and interest, costs and accruing costs since September 20, 1950, and attorney's fees herein.

IV.

That a Judgment and Decree should be made and entered upon these Findings of Fact and Conclusions of Law.

Done in open Court at Juneau, Alaska, this 26th day of January, 1951.

/s/ GEORGE W. FOLTA,
District Judge.

Receipt of copy acknowledged.

[Endorsed]: Filed January 26, 1951.

In the District Court for the Territory of Alaska, Division Number One, at Juneau

Civil Action—File No. 6184-A

JAMES V. COLE,

Plaintiff,

vs.

SAM ASP and MAUDE ASP, Co-partners, Doing Business Under Their Co-partnership Trade Name of SALT SEA FISHERIES,

Defendants,

and

S. EINSTOSS,

Garnishee Defendant.

JUDGMENT AND DECREE

This matter having come regularly on for trial in open Court, without a jury, on January 23,

1951, the plaintiff appearing by his attorney, M. E. Monagle, Esquire, and the defendants having appeared herein by their attorney, William L. Paul, Jr., Esquire, and the garnishee defendant appearing by his attorney, William L. Paul, Jr., Esquire, and it appearing to the Court that this case was filed and docketed in this Court on October 3, 1949, and thereafter a Summons was duly issued out of and under the seal of this Court, which Summons was personally served upon the defendants by the United States Marshal for the First Judicial Division of the Territory of Alaska, at Juneau, Alaska, on October 3, 1949, and within the jurisdiction of this Court, and thereafter defendants appeared herein and filed their Answer to plaintiff's Complaint, and plaintiff thereafter filed his Reply to defendants' Answer; and, that thereafter and on May 2, 1950, William L. Paul, Jr., made and filed herein his Motion for permission to withdraw as attorney for defendants Sam Asp and Maude Asp, co-partners doing business under their co-partnership trade name of Salt Sea Fisheries, and thereafter and on the same day the above-entitled Court made its Order granting the Motion of William L. Paul, Jr., and permitting him to withdraw as attorney for said defendants and directed the Clerk of the above-entitled Court to notify said defendants that this case was set for trial and was to be tried on Thursday, May 4, *1940,* and directing that defendants obtain another attorney to represent them if they desired to do so; and, that thereafter and on May 4, 1950, this case was reset for trial to take

place on May 18, 1950; and thereafter and on May 18, 1950, this case was reset for trial on May 22, 1950; and, it appearing that thereafter and on May 22, 1950, at the request of William L. Paul, Jr., the trial date was reset for June 8, 1950, and thereafter, and on the Motion of William L. Paul, Jr., the case was again reset for trial on June 26, 1950, and that thereafter and on June 29, 1950, the case was reset for trial on September 20, 1950; and, it further appearing that thereafter and on September 20, 1950, this case came regularly on for trial and plaintiff appeared personally and by his attorney, M. E. Monagle, and the defendants Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, failed to appear or aduce any evidence whatsoever on their behalf, and the garnishee defendant S. Einstoss appeared personally and by his attorney, William L. Paul, Jr., and adduced evidence in support of his contention that he was the owner of eighty-five cases containing forty-eight one-pound cans each of silver or cohoe salmon per case, which had been attached and seized by the United States Marshal on October 5, 1949, by virtue of a Writ of Attachment levied upon said cases of salmon in the warehouse of defendants Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, at Tenakee, Alaska, and in support of his contention that said defendants were not the owners of said salmon; and, it appearing that said S. Einstoss had failed to produce his books and records as required by the

subpoena directed to him and issued out of this Court, under the seal of this Court, on June 29, 1950; thereupon, at the request of said S. Einstoss and his attorney, William L. Paul, Jr., the trial was thereupon continued over until said garnishee defendant S. Einstoss could appear and produce his books and records, which Order continuing the date of the trial to December 29, 1950, was made on the condition that S. Einstoss would pay all costs, and that all costs incurred by virtue of the continuance of the trial of this case would be assessed against said garnishee defendant S. Einstoss: and, it further appearing that the trial of this case came before the Court against on December 29, 1950, at which time plaintiff appeared personally and by his attorney, M. E. Monagle, and the defendants again failed to appear or adduce any evidence in their behalf, and the garnishee defendant S. Einstoss failed to appear and adduce any evidence in his behalf, and at the request of William L. Paul, Jr., attorney for S. Einstoss, this Court again continued the trial at the request of William L. Paul, Jr., attorney for S. Einstoss, to January 23, 1951, in order to give said garnishee defendant S. Einstoss an opportunity to produce his books and records, which Order provided that all costs incurred by virtue of said continuance would be assessed against said garnishee defendant S. Einstoss: and, this case having come regularly on for trial in open Court as hereinabove specified on January 23, 1951, and it appearing that by virtue of a Writ of Attachment issued out of and under the seal of this Court

the United States Marshal on October 5, 1949, duly and regularly levied upon, seized, attached, and now holds and has in his possession by virtue of and under the lien of said attachment, one hundred cases of pink salmon which has not been sold as perishable property or discharged from said attachment or the lien thereof, as provided by law, or otherwise, but are now held by virtue of and under the lien of said attachment; and, the Court being now fully advised in the premises, and having heretofore duly made and entered its Findings of Fact and Conclusions of Law;

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed that James V. Cole, plaintiff herein, have Judgement against the defendants Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries, for the sum of $927.00, together with interest thereon at the rate of six per cent per annum from November 1, 1948, amounting to $124.00, making a total Judgment in favor of plaintiff and against defendants in the sum of $1,051.00, together with interest thereon from the date hereof until paid at the rate of six per cent per annum, together with plaintiff's costs and disbursements herein incurred, including the sum of $250.00 as and for attorney's fees; and, it is hereby further ordered, adjudged and decreed that the personal property consisting of one hundred cases of salmon containing forty-eight one-pound cans of salmon in each case and of said eighty-five cases of silver salmon containing forty-eight one-pound cans of salmon in each case,

heretofore duly levied upon and now held by virtue of a Writ of Attachment in the hands of the United States Marshal, which has not been sold as perishable property or discharged from the attachment as provided by law, should not be sold as perishable property or discharged from said attachment as provided by law, but that all of said above described cases of salmon so held by the United States Marshal by virtue of and under the lien of said attachment, be sold to satisfy plaintiff's said Judgment, and that execution issue on this Judgment and that upon said execution the United States Marshal sell said attached personal property and apply it, or the proceeds derived therefrom, to satisfy plaintiff's said Judgment, including costs of sale, accruing costs, and costs and attorney's fees, and that execution issue for any deficiency which may remain, but that the excess, if any, be delivered by the United States Marshal, upon demand, to the defendants Sam Asp and Maude Asp, co-partners, doing business under their co-partnership trade name of Salt Sea Fisheries; and, it is hereby further ordered, adjudged and decreed that the plaintiff James V. Cole have Judgment against the garnishee defendant S. Einstoss and Wallis S. George as surety on his Undertaking heretofore made and filed herein and against Mrs. G. R. Kennedy as surety on her bond and Undertaking heretofore made and filed herein; that said garnishee defendant S. Einstoss pay the Judgment of James V. Cole against the defendants herein by redelivering said eighty-five cases of attached silver salmon, or that said S. Ein-

stoss and the sureties on his bond, Wallis S. George and Mrs. G. R. Kennedy, pay the sum of $1,530.00, which is the value of those certain eighty-five cases of forty-eight one-pound cans in each case of silver salmon heretofore attached by the United States Marshal and thereafter delivered to the garnishee defendant S. Einstoss on his claim of ownership, upon his making and filing his said Undertaking for delivery with said Wallis S. George and Mrs. G. R. Kennedy as sureties on said Undertaking for delivery, or so much of said $1,530.00 as may be necessary to fully satisfy plaintiff's Judgment, together with principal and interests, costs and accruing costs since September 20, 1950, and attorney's fees herein.

Done in open Court at Juneau, Alaska, this 26th day of January, 1951.

/s/ GEORGE W. FOLTA,
District Judge.

Entered Court Journal No. 20, pages 95-96-97.

Receipt of copy acknowledged.

[Endorsed]: Filed January 26, 1951.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice of appeal is hereby given by S. Einstoss, garnishee defendant above named, that he appeals to the Court of Appeals for the Ninth Circuit from

the judgment of the above-entitled Court of January 26, 1951, in this cause.

Appellant requests that supersedeas bond be fixed at $2,000.00.

/s/ WILLIAM L. PAUL, JR.,
Attorney for
Garnishee-Defendant.

[Endorsed]: Filed February 24, 1951.

[Title of District Court and Cause.]

STATEMENT OF POINTS RELIED ON BY APPELLANT

1. There is no evidence at all that the property attached by the Marshal at Tenakee, Alaska, and claimed by garnishee-defendant belongs to any person other than the garnishee-defendant.

2. All the evidence shows that said property has always belonged to garnishee-defendant.

3. The Marshal testified without objection that at the time he made the levy on the property at Tenakee, Alaska, he was told by defendant Maude Asp that the property was owned by the garnishee-defendant; and the Court erred in refusing to consider this evidence.

March 7, 1951.

/s/ WILLIAM L. PAUL, JR.,
Appellant's Attorney.

Receipt of copy acknowledged.

[Endorsed]: Filed March 9, 1951.

[Title of District Court and Cause.]

DESIGNATION OF PORTIONS OF RECORD TO BE PRINTED

To the Clerk of the Above-Entitled Court:

You are hereby requested to prepare, certify and transmit to the Clerk of the United States Court of Appeals for the Ninth Circuit at San Francisco, with reference to the notice of appeal heretofore filed herein, transcript of the record in this cause, transmitted and prepared as required by law and the rules of court, and to include in said transcript the following:

1. Complaint filed October 3, 1949.
2. Writ of attachment of October 3, 1949, with return.
3. Motion to quash service of writ filed October 22, 1949.
4. Affidavit received in evidence November 10, 1949.
5. Affidavit with exhibits attached filed April 19, 1950.
6. Motion for summary judgment filed April 19, 1950.
7. Affidavit filed May 3, 1950.
8. Cost bill filed January 26, 1951.
9. Findings of fact and conclusions of law dated January 26, 1951.
10. Judgment dated January 26, 1951.
11. Notice of appeal filed February 24, 1951.

12. Statement of points on which appellant relies on appeal.

13. This designation.

14. Transcript of testimony.

/s/ WILLIAM L. PAUL, JR.,
Appellant's Attorney.

[Endorsed]: Filed February 26, 1951.

[Title of District Court and Cause.]

PLAINTIFF'S DESIGNATION OF CONTENTS OF RECORD ON APPEAL

The plaintiff, James V. Cole, respectfully suggests and requests that in addition to the portions set forth in plaintiff-appellant's "Designation of Contents of Record on Appeal," the following hereinafter mentioned and designated portions of the record, proceedings, and evidence submitted upon the hearing of said cause, to be contained in the record on appeal, and requests the Clerk of the above-entitled Court to prepare, certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit Court, as part of the transcript of record, the following:

1. Affidavit of M. E. Monagle filed May 3, 1950, in opposition to S. Einstoss' Motion for Summary Judgment.

2. Motion of James V. Cole filed May 3, 1950, for extension of time for hearing of Motion for Summary Judgment.

3. Subpoena Duces Tecum of June 9, 1950, directed to S. Einstoss, together with Marshal's Return thereon.

4. Subpoena Duces Tecum of June 29, 1950, directed to S. Einstoss, with Marshal's Return thereon.

5. Minute Order of the District Court dated November 14, 1949.

6. Minute Order of the District Court dated May 5, 1950.

7. Minute Order of the District Court dated May 18, 1950.

8. Minute Order of the District Court dated May 22, 1950.

9. Minute Order of the District Court dated June 9, 1950.

10. Minute Order of the District Court dated June 29, 1950.

11. Minute Order of the District Court dated September 20, 1950.

12. Minute Order of the District Court dated December 29, 1950.

13. Minute Order of the District Court dated January 5, 1951.

14. Minute Order of the District Court dated January 23, 1951.

/s/ M. E. MONAGLE,
Attorney for Plaintiff.

Receipt of copy acknowledged.

[Endorsed]: Filed March 7, 1951.

In the District Court for the Territory of Alaska, Division Number One, at Juneau

No. 6184-A

JAMES V. COLE,

Plaintiff,

vs.

SAM ASP and MAUDE ASP, Co-partners, Doing Business Under Their Co-partnership Trade Name of SALT SEA FISHERIES,

Defendants,

and

S. EINSTOSS,

Garnishee-Defendant.

REPORTER'S TRANSCRIPT OF TESTIMONY

Be It Remembered, that on the 20th day of September, 1950, at 10:00 o'clock a.m., at Juneau, Alaska, the above-entitled cause came on for hearing, the Honorable George W. Folta, United States District Judge, presiding; the plaintiff appearing by M. E. Monagle, his attorney; the garnishee-defendant appearing in person and by William L. Paul, Jr., his attorney; and, respective counsel having made opening statements to the Court, the following testimony was adduced: [1*]

* Page numbering appearing at foot of page of original Reporter's Transcript of Record.

SIGMUND EINSTOSS

called as a witness on behalf of plaintiff, being first duly sworn, testified as follows:

Direct Examination

By Mr. Monagle:

Q. Will you state your name?

A. Sigmund Einstoss.

Q. Mr. Einstoss, do you know Sam Asp?

A. Yes, sir.

Q. Do you know Maude Asp? A. Yes.

Q. And how long have you been doing business, if any, with Sam Asp and Maude Asp, doing business as Salt Sea Fisheries at Tenakee, Alaska?

A. They packed salmon for me once several years ago. I don't remember the exact year, and this is the second time. I mean 1949 was the second time they packed salmon for me.

Q. They packed salmon for you in 1949?

A. Yes.

Q. And you say they packed salmon for you prior to that? A. Yes.

Q. What year?

A. I don't remember the exact year.

Q. Well, do your books show it?

A. The books would show it; yes.

Q. Let's see your books. [2]

A. Not these books wouldn't show it. It has nothing to do with this; this is for 1949.

Q. You have a separate set of books for each year?

(Testimony of Sigmund Einstoss.)

A. I have books in Seattle that would show.

Q. You were subpoenaed to bring books of all your dealings with Sam Asp.

A. I understood you meant 1949. I don't see it has anything to do with it for prior years, five or six years ago.

Mr. Paul: I think counsel should show some materiality for 1945 or 1946. It wouldn't seem to have anything to do with this.

The Court: Am I to understand that the record for 1949 also includes the records for previous years?

A. No, sir.

Q. What kind of books do you keep?

A. I am not a bookkeeper. I really don't know.

Q. I didn't ask you if you kept books. I asked you if you had books, Mr. Einstoss. What kind of books have you? What kind of books does your bookkeeper keep for you?

A. I don't know.

Q. You didn't see them?

A. I did see them, but I don't know anything about books.

Q. Well, what did you put in the books that you do have?

A. I never put in anything myself.

Q. Well, what does your bookkeeper put in them? [3]

A. I don't know; everything pertaining to the business, I presume.

Q. When you say "everything pertaining to the

(Testimony of Sigmund Einstoss.)

business," what do you mean? How much fish were bought and how much you paid for them; is that it?

A. All the transactions, buying, selling, and expenses in connection, and so on and so forth.

Q. And who the fish were bought from?

A. Yes.

Q. And who bought them?

A. I suppose so.

Q. And what commission was paid for buying them? A. Yes.

Q. Does that include all kinds of fish that you bought during the year? A. What year?

Q. Any year.

A. I suppose that is the way they keep them.

Q. You say you had an agreement with Sam Asp and Maude Asp to pack fish for you during the year 1949? A. That is right.

Q. Now, when was this agreement made between you and Mr. and Mrs. Asp?

A. It was sometime prior to the commencement of the season. She came down to Ketchikan, and we made an agreement. [4]

Q. And you say she came down—who came down? A. Mrs. Asp.

Q. Were all your negotiations for this contract with Mrs. Asp?

A. No. Sam Asp was in the office in Seattle first.

Q. When was that?

A. Sometime in the spring of 1949; and we didn't come to an agreement. And finally she come down to Ketchikan, and we made an agreement.

(Testimony of Sigmund Einstoss.)

Q. Now, what were the contents of the agreement which you made with her?

Mr. Paul: Let's produce the agreement, your Honor.

Mr. Monagle: I have a right to have him testify what the contents were of any agreement he made with her or Sam Asp.

Mr. Paul: If he is examining as to credibility; yes.

Mr. Monagle: In his affidavit he says it is partly in writing and partly oral. It is his own affidavit. He swore to it.

The Court: If that is the situation, then of course he can answer the question.

Mr. Monagle: It is in the affidavit on file, may it please the Court, his sworn affidavit.

The Court: It isn't challenged, I guess.

A. We agreed they would buy salmon for me and pack them—that [5] is, can them—and I am to pay them, and they are to furnish labor, cans, cartons, and I am to pay them $3.50 a case, and I am to advance the money for fish and for the cans and cartons and also pay them some money on account during the canning season, and I am to withhold, I believe, either fifty cents or a dollar a case until the fish are examined by the National Canners.

The Court: Did you say fifty cents?

A. I believe, fifty cents per case until the fish are examined; either a dollar or fifty cents. We have the contract here. It speaks for itself.

(Testimony of Sigmund Einstoss.)

The Court: I understand you to say you agreed to pay them fifty cents per case until the fish were accepted?

A. No. I agreed to pay them whatever they need for payroll, and not to exceed the full amount, and also advance the money for the cans and for the cartons, and also guarantee the oil for them, and all this is to be deducted from the $3.50, but before final settlement I should withhold, I believe, fifty cents a case until the fish are examined by the National Canners, until found to be suitable for human consumption, and, if not found suitable for human consumption, they would have to be reconditioned; they are to stand all the expenses and they are to pay for those fish that are condemned by the National Canners, if any.

Q. Now, as I understand your testimony, they were to furnish [6] all the labor and cans and boxes, or the cartons that the fish was packed in; is that right? A. That is right.

Q. And then they were supposed to pack fish?

A. Yes.

Q. Now, who was supposed to furnish the fish?

A. I am supposed to furnish the fish, furnish the money to buy the fish with.

Q. What do you mean, furnish fish or furnish money to buy fish?

A. I didn't have no fish. I had to furnish money to buy fish with.

Q. You furnished money to buy fish with?

A. So I was to furnish the fish, naturally.

(Testimony of Sigmund Einstoss.)

Q. Who was to pay for the labor, cans, cartons, salt, and oil for runing the cannery, and other items? A. Sam Asp and Maude Asp.

Q. They were to pay for that? A. Yes.

Q. Now, what is the cost of a carton of cans, talls?

A. A carton of cans is approximately a dollar and a half per case plus freight.

Q. And how much is freight on a case of cans to Tenakee?

A. I don't know. It came about a dollar and a half. I think that included the freight. The cans, the cartons and the [7] freight, I believe it came to about a dollar and a half.

Q. Now, was there any other agreement between you and Sam Asp or Maude Asp with reference to the canning of these fish?

A. No. The agreement was covered for the year 1949.

Q. And now, what correspondence passed between you and either Sam Asp or Maude Asp with reference to making this contract?

A. I don't think I have had any correspondence with them, except that he was in the office once, and then I didn't pay much attention to it, and finally she came down to Ketchikan, and we then agreed and signed an agreement.

Q. Well, now, in an affidavit that you swore to on April 11, 1950, you state that "written portions of said contract evidenced in letters between affiant and defendant, some of which letters are attached

(Testimony of Sigmund Einstoss.)

and made a part hereof." One letter was attached. Where are the other letters?

A. I don't remember exactly. The lawyer made out the affidavit, and I signed it. It speaks for itself.

Q. I know it speaks for itself, but I want to know where the letters are that it speaks of.

A. I don't remember now if we had any letters or not.

Mr. Paul: Your Honor, we are responding to the subpoena that required us to produce all documents, correspondence, affecting the relation. Everything is here if counsel wants to look over it, and to ask the witness for intimate [8] knowledge of everything in this file is going too far. If there are extra letters, in view of his statement that he doesn't know, we will let counsel look over them.

A. I couldn't remember right now.

Mr. Monagle: I don't have to assume that he brought all his letters. He swears that he has letters, and I am just asking where they are.

The Court: So long as the examination doesn't relate to the contents of any particular letter, I think it is proper as presently conducted. Objection overruled.

Q. Where are those letters? Do you have them with you, Mr. Einstoss?

A. If there is any letters, they are all in the files.

Q. Well, get them out, please, if you will.

Mr. Paul: Start looking, Sig.

A. What is that?

(Testimony of Sigmund Einstoss.)

Mr. Paul: Start looking.

Q. I want all of them.

Mr. Paul: Find all the letters; of any date.

Q. Now when was this undated letter, or appears to be a letter, written to S. Einstoss at Ketchikan and purportedly signed by Sam Asp and Maude Asp, when was that letter——

A. That was just a few days before the season commenced; it was made in my office by me and her.

Q. That was made in your office by you and Mrs. Asp? [9] A. Yes.

Q. And where was that made?

A. In Ketchikan.

Q. And now, "a few days before the season commenced"; when would that be?

A. I don't know the exact date the season commenced in 1949. I think it was the same time as this year, I believe. It was some time in August.

Q. Sometime in August?

A. I don't know that.

Q. Who typed that letter?

A. She typed it.

Q. Where? A. In my office.

Q. In your office. And how many copies of that were made?

A. I don't know. I think there was a copy.

Q. When those copies were made, or that copy if there was only one, what became of it? Didn't she give it to you? A. A copy?

(Testimony of Sigmund Einstoss.)

Q. Yes. Has that copy been in your file ever since it was made?

A. Yes. It was in my files.

Q. At all times? A. Yes.

Q. Never been out of your files? [10]

A. No.

Q. I want to know how Sam Asp's name got on it, then. He wasn't in Ketchikan, was he?

A. I think I gave it to my man in charge, and he had Sam Asp sign it and send it back.

Q. Who was your man in charge?

A. A young man; he was a medical student; his name was Marvin Rubinstein.

Q. Marvin Rubinstein. And what did a man by the name of Oakson do?

A. He was in the fall of the year; Oakson was there in the fall of the year.

Q. Now, what do you mean by "fall of the year"?

A. The second season. That has nothing to do with this season.

Q. And Rubinstein was there the first season?

A. Yes.

Q. Now, you claim that Rubinstein took that agreement with him to Tenakee?

A. I gave him, or mailed it to him and told him to see that Sam Asp signed it and send it back to me.

Q. Now, have you any explanation of why there is no date on that?

A. Simply a mistake, a lot of people in the office,

(Testimony of Sigmund Einstoss.)

simply overlooked, no intention; there should be a date.

The Court: You are speaking of the [11] season——

A. The first, the summer season.

Mr. Monagle: We will offer that.

The Court: It may be admitted and marked Plaintiff's Exhibit No. 1.

Clerk of Court: The exhibit will be so marked.

Q. Now, what other correspondence passed between you and Mr. or Mrs. Asp during the year 1949?

A. That is all I could find. I gave you those two letters right now.

Q. Do you know of any other, besides these two letters?

A. Not this minute. I told my office to get all the correspondence and records in connection with the Tenakee 1949 operations and send it to me here, and I got it here two days ago.

Q. The only letter here with reference to any salmon that was canned is the letter of October 16, 1949, from W. K. Oakson, covering a shipment of 565 cases of salmon. Now, do you mean to tell us that was all the salmon that was shipped from there? A. I didn't say that.

Q. I want to know where the other reports are, the other letters about shipment of fish.

A. There are some bills of lading.

Q. Well, I want to ask you this. Isn't it a fact you got regular reports from Tenakee all the time

(Testimony of Sigmund Einstoss.)

as to what fish [12] was being packed and what was being done?

A. I cover several stations and I never keep records. I don't know what we have and haven't. This young man was not experienced. He done something that he shouldn't have done. And the only reason I sent him down was I know him to be honest, and I expected him to keep records, and what correspondence or records we have I don't know exactly except that I told my office to airmail all the records we have in connection with the 1949 Tenakee operation, and I received it here and I gave it to you.

Mr. Paul: May I suggest a method of shortening this? In order to assist counsel perhaps in a more detailed examination of our records and save the Court's time, the witness can identify all the records. The examination will show there were written reports, and counsel can get all sorts of information.

The Court: That may be, but counsel can't be shut off from examination of what he knows. It is presumed that he is the head of the business and how it is conducted and probably reviews the records at some time.

Mr. Paul: But essentially that examination, your Honor, is to test the credibility of the witness and the sufficiency of the records.

The Court: I thought that was what he was doing.

(Testimony of Sigmund Einstoss.)

Mr. Paul: I thought he was trying to find out the [13] number of cases.

The Court: The Court is not disposed at any time to tell counsel how to conduct his examination.

Mr. Monagle: I am questioning the veracity of the statements and when they were made, is all. I don't believe they were made at the time at all; I don't mind telling you.

The Court: You may proceed.

Q. Now. was there any other letters besides Plaintiff's Exhibit 1 here that passed between you and Sam Asp or Maude Asp with reference to them packing fish for you during the year 1949?

A. If there was, I don't know off hand at this moment.

Q. Well, you say there is or isn't?

A. There may be. Maybe if I asked them to search for more.

Q. Where would they search for more?

A. In Seattle.

Q. You were required to bring everything.

A. I told them to get all the records in connection with the operation of 1949 with Sam Asp in our possession. I presume that is what they gave me.

Q. Now, do you know how many cases of salmon were packed by the Salt Sea Fisheries, by Sam Asp and Maude Asp, during the year 1949?

A. I know if I look at the records, yes.

Q. Well, look at the records and tell me. You go ahead and [14] take a look.

(Testimony of Sigmund Einstoss.)

(Witness stepped down to his counsel's table.)

Mr. Paul: 6958, all species, first and second season.

(Witness resumed the stand.)

A. 6958 during the year of 1949 according to the records we have got here.

Q. According to your records there were 6958 cases of fish packed, is that right, during the 1949 season? A. Yes.

Q. Is this a true and correct record of what your books show with reference to the fish that was packed for you by Mr. Asp and Mrs. Asp?

A. This is the true records sent to me by my Seattle office.

Q. I don't see any place where is says 6958 cases. Is that supposed to be your total of the cases packed? You have to testify. I want you to testify to these facts.

A. Is it there, or did you add them up?

Mr. Paul: I just took the total. That is what counsel asked for.

A. Do you want me to testify in detail?

Q. I want to know how many cases of all kinds of fish were packed by Sam Asp and Maude Asp at Tenakee the season of 1949?

A. As far as I know, I can tell you again and again the same story, no other story. I have no reason to make any different statement than I made, that I keep no books; I [15] know nothing about

(Testimony of Sigmund Einstoss.)

records. I asked my office to send down all the records, and this is what they show, and that is all I can tell you.

The Court: Mr. Einstoss, the thing I don't understand is this. You say you don't keep any books. Of course you do like any other person that runs a business, but don't you keep track of the books to see that they are correct? Anybody can run off with your business.

A. I have an accountant come in and check it up, but I don't personally know anything about books. I have two years of public school.

The Court: Who furnishes the material that goes into the books that makes the records so that an accountant—are you at the mercy of an accountant, whatever he tells you?

A. Yes, I am at the mercy of an accountant. A fellow got away with thirty thousand dollars from me last year. When I found out, it was too late.

The Court: Who is it that furnishes the figures and information that goes into the books and records?

A. I usually tell the bookkeepers what is what.

The Court: Then you give them the information before they put it down? A. Yes.

The Court: Then why don't you remember it?

A. Do you expect me to remember all year the details when I [16] am so busy between here and New York?

The Court: You might not remember all the details, but from what you tell the counsel here,

(Testimony of Sigmund Einstoss.)

you don't remember any. Now, you must remember—if you give them the information to enter in the records, you would certainly have some recollection of some of the transactions, wouldn't you?

A. Not of the exact amounts. Of that I have no recollection.

The Court: Have you sufficient recollection so that when you do look over the records you can tell whether they are correct or not?

A. I want to tell the truth. I don't know because—I will tell you why, your Honor—because Sam Asp, I found out later that he spoiled some of the fish, and I have several thousand dollars coming from him and I know he didn't sell them and didn't make any difference whether he did or whether he didn't. I operate six stations in Southeastern Alaska plus some place else and I can't remember everything.

The Court: Well, do you have any way of telling whether the information that you give your bookkeeper to enter is ever included or not? How do you know that your bookkeeper puts down what you tell him or her?

A. That is all up to the accountant.

The Court: But the accountant knows nothing except what he finds on the books. [17]

A. They give me statements from time to time, and I look it over then.

The Court: Who gives you the statement?

A. The accountant.

The Court: Well but what I am trying to find

(Testimony of Sigmund Einsfoss.)

out, are you and the accountant at the mercy of the bookkeeper? Suppose the bookkeeper happens to be dishonest and, instead of putting down the information or figures that you give her or him, he doesn't do it, then how can you check on that?

A. Maybe bad business in that respect. See, I am away several months and——

The Court: I just want to understand how you keep your records; that is all.

A. I don't know nothing about books, your Honor. I have no reason but to tell the truth.

The Court: Proceed.

Q. Well, I want to know whether or not Sam Asp and Maude Asp packed five hundred or six hundred or six thousand cases.

A. According to my records it shows 6,958 cases.

Q. Cases? A. Yes.

Q. In your affidavit you filed in this court previously, which you made on April 11, 1950, of this year, you filed a statement here which purports to show the amount of cash advanced to Sam Asp. Now, it shows a total of amount [18] advanced, and then there is a figure under it. Now, is that supposed to be the difference between what you paid out and what you got back, or what is it supposed to be?

A. It shows I paid him $8,848.00, and then it shows something—$7,897.96. What that is supposed to be, I don't know. I sent them the statements, whatever the bookkeeper made.

(Testimony of Sigmund Einstoss.)

Q. You swore to it. You know what you are swearing to, don't you?

A. The account is correct, given by me to the bookkeeper, and I attached it to the affidavit.

Q. You don't know if it is true or not?

A. It must be true if the bookkeeper gave it to me.

The Court: How long has this bookkeeper been in your employ?

A. This man?

The Court: Yes.

A. I think he started this spring, sometime.

The Court: How many bookkeepers do you have?

A. Three.

The Court: How long have the other two been in your employ?

A. One is only about four or five months, and the other about a year. I had a bookkeeper and I found out he embezzled about thirty thousand dollars.

The Court: Over what period of time? [19]

A. About a year and a half or two, something like that.

The Court: Was he the only bookkeeper?

A. He was the head bookkeeper in charge.

The Court: And it is because of that that you got all new bookkeepers; is that it?

A. One was there before. I fired the bookkeeper and the accountant.

The Court: You mean even the accountant——

(Testimony of Sigmund Einstoss.)

A. I blamed it on the accountant. He sent in another man who didn't check right.

The Court: The accountant had to take the records as presented to him, didn't he? How could he determine there was stealing if it was covered up?

A. Well, he makes a check payable to the bank and gets another check and cashes it. The accountant should know what the check covered.

The Court: How did you find out about that?

A. I didn't find it. When I was there, he deposited the check for his own account. Somehow he slipped up and left the slip for the same amount he gave a check for.

The Court: Then you don't really know how your books are kept; anybody can get away with anything; is that it?

A. It would seem so. I am honest and I figure the other fellow is, but it was the other way.

Q. Then you don't know whether these are true or not if you [20] had dishonest bookkeepers? You don't know if your books are right or not?

A. I believe this is correct. I couldn't explain anything on the books.

Q. If what you testified to here is correct, where is the rest of the money that you owe Sam Asp? If he canned 6,958 cases of fish for you, and you got it, as you testified, at $3.50 a case, it is certainly more than $8,000.00. A. I paid for the cans.

Q. How much?

A. About a dollar and a half a case, and I, then

(Testimony of Sigmund Einstoss.)

I paid for reconditioning the salmon, $2.00 a case—how many was that?

Mr. Paul: You are testifying.

Q. 6,958.

A. And I dumped some of the salmon. It was condemned by the National Canners.

Q. According to this record here that you have just testified to, which is designated "Summary of fish received at Tenakee during 1949," you have got here "Reconditioned, $265.40." A. 265 cases.

Q. One part of this lot, $123.20 covers loss and reconditioning; that is a total of about four hundred dollars there? A. Yes. [21]

Q. Was the bookkeeper wrong on that again?

A. No. We got several others.

Q. How many sets of books do you keep?

A. We have the records right here.

Q. You said that was your record.

Mr. Paul: No, no, counsel; don't put words in the witness' mouth. You haven't asked for all the books.

Mr. Monagle: I haven't asked for a book.

Mr. Paul: Don't try to get all the books out of that little sheet of paper in his hand.

Mr. Monagle: I am going to ask for the books when I get ready.

Mr. Paul: Don't trap the witness.

Mr. Monagle: I object to his attorney testifying for him all the time.

The Court: Well, remarks, of course, of that kind should not be made, and counsel ought to ad-

(Testimony of Sigmund Einstoss.)

dress themselves to the Court, also. Now, this statement that is attached to Exhibit No. 1, that he has been questioning you about, does that show all the money that you advanced?

A. For the spring operation; yes.

The Court: Why hasn't it got the item for cans then?

A. She came down to Ketchikan. We made it up then and showed it to her, and she O.K.'d it, the cash she received.

The Court: But you say you paid for the cans. [22]

A. I did.

The Court: Why isn't it on here?

A. I showed her what cash she received.

The Court: You mean it is included in the item "cash"?

A. No.

The Court: Is it shown in any of those items?

A. No.

The Court: What was the purpose of that statement?

A. She come down and she knows she got no money coming, and I showed her what she received in cash, and she had no money coming. She knew I shipped the cans.

The Court: What isn't clear to me is, if you put down the cash in advance and also the money that you spent on various things here—there is a lot of items—why didn't you put the cans down?

A. At that particular time we figured out the

(Testimony of Sigmund Einstoss.)

amount of cans packed, and the amount of cash advanced, plus the cans, was more than she had coming, and there was an oil bill to be paid that I guaranteed for the season for $508.00 not included in there, and she was not supposed to get any final statement until the salmon are examined.

The Court: Then what was the purpose of this statement?

A. To show her how much cash she received. She figured [23] approximately two dollars a case she had coming if she——

The Court: Now, when you have an item here "wharfage and freight on salt," she didn't get that, did she?

A. May I see that? My man paid it in her cannery. I got it from him, and she come down and thought she had more money coming, and I showed her she was overpaid.

The Court: Was that statement intended to show how much money you were out at the time the statement was prepared?

A. How much cash she received.

The Court: And how much money you spent?

A. Yes; cash.

The Court: And why didn't you include the cans?

A. She knew about that.

The Court: She must have known about some of these other items too, then.

A. I had better than five thousand cases left at the end of the season. I didn't pick them up.

(Testimony of Sigmund Einstoss.)

The Court: Did you leave out anything in addition to the item of cans?

A. Except the oil bill; I didn't have the bill then from the Union Oil when she came down to Ketchikan. We figured the cans approximately a dollar and a half, and $2.50, she didn't have that much coming at the time.

Q. Do I understand you to testify now that at the end of the [24] season you had five thousand cases of cans at Tenakee? A. I did.

Q. Is that what you are testifying under oath to the Court here?

A. In his place—what's his name? Tennyson's. The steamship couldn't deliver.

Q. I am talking about Sam Asp, not Tennyson.

A. I don't remember exactly how many.

Q. He didn't have any of your cans there, did he?

A. He did. They were shipped to Sitka from there.

Q. When the marshal went over and attached or foreclosed the mortgage on every can in the place, why didn't you claim them if they were yours? The marshal foreclosed the mortgage and took all the cans out of there——

A. My cans were probably shipped out prior to the marshal's arrival there.

Q. As a matter of fact, you didn't furnish any cans; the cans were furnished by Reno-Johnson-Sjoblom, Inc.? A. That is not so.

Q. I want you to read that letter in which the

(Testimony of Sigmund Einstoss.)

attorneys are trying to collect for the cans they sold Sam Asp for the 1949 season.

A. That was in March; that was prior to the time—I didn't know anything about the transaction at all.

Q. Look at the date again, Mr. Einstoss. That is March, 1950. He is trying to collect for 1949 cans. [25]

A. That was prior to the time that I entered in the transaction with them; that was the year before.

Q. Read the letter again, Mr. Einstoss—it says 1949 season in May—before you testify.

Mr. Paul: What has that got to do with the season starting August 15, 1949, your Honor?

Mr. Monagle: The Court knows of his own knowledge that they don't pack salmon between May and August in this country.

The Court: I assume they get the cans before the season opens.

A. Dated May 9 for some cans; these cans were shipped by another man, Gene O'Brien, who was supposed to finance them and who they had a disagreement with, and these fellows bought the cans, and they expected to go in but they didn't. I knew nothing about it and don't know now, but that has nothing to do with my transaction at all. I shipped out cans. I bought three thousand cases, I think, from the Douglas Canning Company here and I shipped out two thousand cases—no, I think about five thousand cases or more; I don't know exactly—from the Continental Can, but I supplied more than

(Testimony of Sigmund Einstoss.)

enough cans for my salmon, and until about the middle of this summer I used them in Juneau at Don Milnes' place, from John Tennyson at Tenakee, because their dock was not safe and the Alaska Steamship wouldn't [26] go there and deliver it, and some of the cans that were left over, my cans, were shipped over to Sitka on the boat "Forester." I supplied all the cans that was needed in connection with my canning there, plus——

Q. You know those eighteen hundred cases of cans were shipped in there, but these people, you said, were going back for them.

A. I don't know at all about it.

Q. You just testified to it, didn't you, that a fellow by the name of Kelly or something——

A. I heard later. I know it now.

Q. You know they had over two thousand cases of cans?

A. That had nothing to do with my cans whatever. I had my own cans and more than too much. Five thousand were brought into Juneau, and about six or seven or eight hundred cases were shipped to Sitka at the end of the season.

Q. What, if any, statement did you ever make in connection with your operations out there—I mean written statement or accounting—since April 11, 1950, or since the statement attached to your affidavit of April 11, 1950? What other statement have you made, or accounting, between you and Asps than the one that is attached to this affidavit here?

A. To who?

(Testimony of Sigmund Einstoss.)

Q. Sam Asp, Maude Asp, or either or both of them. [27] A. None I know of right now.

Q. What became of the rest of the money then for the 6958 cases?

A. They owe me thousands of dollars now which I don't expect to collect because they are insolvent.

Q. Why wasn't that shown on this statement attached to your affidavit?

A. What they owe me?

Q. This was supposed to be a statement of the conditions that existed between you and them, wasn't it?

A. I don't know what it is supposed to be. I told the bookkeeper to make up a statement and I suppose that is what he made.

Q. When you swore to this affidavit, you don't mean to say that you put an untrue statement on it?

A. I didn't intend to put in an untrue statement and I don't now. I asked the bookkeeper to make up a statement and I told him to mail it to him, and I probably never seen it.

Q. What kind of a statement?

A. In connection with the dealings with Sam Asp.

Q. A true and correct statement?

A. Supposed to be; absolutely.

Q. Look at this statement. It can't possibly be true and correct, could it? If you can buy six thousand cases of fish for eight thousand dollars, why you would buy them every day, wouldn't you? [28]

(Testimony of Sigmund Einstoss.)

A. They didn't charge them with those cases at all. This shows what we paid.

Q. That is not a true statement then?

A. I wouldn't say it is or it isn't. It is the statement we had at the time. The cans were never charged to him, so they were not on the books.

Q. Don't you mean to say, it was just made up for the purpose of this case; wasn't it?

A. No, not at all.

Q. Have you made a true statement since then?

A. I made no statement of any kind.

Q. Has your bookkeeper made a true statement?

A. Yes.

Q. Do you know how you stand now with Sam Asp and Maude Asp?

A. They owe me several thousand dollars.

Q. Will you show me your ledger sheet showing how much they owe you?

A. I figured it this morning.

Q. I want to see your books.

A. They come from the books.

Mr. Paul: Come get them.

A. No use for me to figure it because I know I can't collect anything.

Q. To save time, I don't want to see a bunch of work sheets; I want to see the books. [29]

Mr. Paul: There has been no offer of work sheets, your Honor.

The Court: He is just warning you.

Mr. Monagle: Just saving time is all.

Mr. Paul (Addressing the Witness): Take the

(Testimony of Sigmund Einstoss.)

whole business, statements of accounts, three thousand cases from Douglas Canning Company.

A. Well, I am no bookkeeper. I can't tell you anything about the records. All I know is that we bought three thousand cases from the Douglas Cannery and we shipped out many thousands of cases of cans which were probably not charged to Sam Asp. There was no reason to charge Sam Asp. All we charged him was cash advanced and, when I figured up after the salmon were examined, we found they owed several thousands of dollars.

Q. I asked for the books that your bookkeeper keeps showing this.

A. These are the records my bookkeeper sent me.

Q. I want your books, not something that somebody copied out of some books. The subpoena said your books, not some extracts from the books.

A. I understood the records, not the exact books.

Q. You were in Court before when the matter was gone into with the Judge right here and you said it would take you three weeks to get them from New York. [30] A. I was in court?

Q. You were here and told the Judge that it would take you three weeks.

Mr. Paul: No. It was my statement.

Mr. Monagle: He was under subpoena. He was at the door. To refresh the Court's memory, when Mr. Paul insisted on this case being put over until today, he said the season wouldn't end until—this was first set for June sometime, and he said that Mr. Einstoss couldn't get his books from New

(Testimony of Sigmund Einstoss.)

York prior to three or four weeks and the season would then be in course and that he couldn't possibly get here until after the fishing season and he insisted it wouldn't be before September 20th.

Mr. Paul: Your Honor, if they want the original invoices that are reflected by the figures the witness has in his hands, we have them here.

The Court: Well, as I understand it, what counsel wants is something not only complete but something in the way of a ledger sheet or the account itself that would show at a glance the state of the dealings between them and any balance or credit, and counsel probably doesn't want to, unless he has to, examine each individual invoice or receipt but, if you don't have the ledger account but you have what makes up the ledger account so that it shows the account between them complete, I suppose, although that would take longer, it will [31] have to be gone into.

Mr. Paul: The witness has in his hand, your Honor, an account that is just about as complete as it is possible to get. There is only one or two items that he has already mentioned. That is the oil bill——

The Court: He has testified now here for probably half an hour on cans alone. I don't understand his testimony yet. I don't understand whether the cost of the cans that were furnished is included, for instance, in the first item "Cash, $2904.00." He has made statements from which you could infer that and he has made statements contradictory,

(Testimony of Sigmund Einstoss.)

though now, I am like counsel, I don't know what it is here in this courtroom today that shows the state of the account between the Asps and the claimant here.

Mr. Paul: Your Honor, that is one of the reasons I made the suggestion that counsel take all our papers and look over them. We spent a lot of time discovering the discrepancy between eight thousand some odd dollars in the statement that was attached to the affidavit and the figure just underneath, seven thousand and eight hundred some dollars. When you look at it, there are two items crossed off, and the difference between the two figures is exactly the sum of those two items. The obvious explanation is that the lower figure was typed in later.

The Court: Why isn't the upper total crossed out? [32]

Mr. Paul: I don't know, but the most obvious explanation is that it just wasn't crossed out. If we can spend a little time doing that, I think—counsel is just kind of fishing around hoping that one or two of these obvious discrepancies might trip up the witness. When they are explained——

Mr. Monagle: May it please the Court, a child in the second grade can multiply 6958 by $16.25 and get more than all these figures doubled again. It shows on its face it is not correct.

Mr. Paul: It is not the full account.

The Court: That is what he is examining him on, as to the full and complete account between them.

Mr. Paul: The witness has it, as I say, except

(Testimony of Sigmund Einstoss.)

for one item, and here is the invoices to substantiate everything in the account.

Mr. Monagle: That is the whole thing, may it please the Court. I don't have to assume that all the invoices are there. They can come in here with self-serving invoices and then want to confine us to that on examination. In other words, Mr. Einstoss testified he has three bookkeepers. Now, he certainly can't convince me, and I don't think he can convince the Court that his bookkeepers keep books like that. Those aren't his books, and he knows it.

A. That is not so. I don't know anything about it. This is the correct copy from the bookkeepers that you asked me to [33] bring. May I make a statement? I say on oath that these papers that you got before me represents cash and nothing for cans.

The Court: But what is there that shows the complete account between you and the Asps? This isn't of much value unless you have something that shows the complete account.

A. This was just cash and not cans.

The Court: I know it doesn't cover cans, but I don't see why it doesn't. If you make out a statement as to what you have spent——

A. Just a temporary statement, this particular statement, to show how much cash we advanced to the account until——

The Court: I know it wasn't the final statement but, if it was a statement before the final statement, why didn't it contain everything you advanced up

(Testimony of Sigmund Einstoss.)

until that time? That is what isn't clear to me.

A. It wasn't necessary in my mind at that time. All that was necessary at the time was to show the cash. She knew it was $1.50 and she had no money coming. When we found at the end of the season that some of the salmon were condemned, they owed several thousand dollars. It was no use doing anything because they haven't got nothing.

Q. When you were in Mr. Ziegler's office a week ago and had him phone up and find out who was going to pay your fare up here or if your deposition could be taken, he told you [34] that I wanted your books, didn't he? You knew that subpoena called for your books. You mean to say Mr. Ziegler didn't tell you that?

A. I don't remember the exact words that he said. I asked for records, and that is what I got.

Q. This subpoena said to bring all your cancelled checks. Maybe that will explain it. Have you got all your cancelled checks here?

A. They sent me all this. I never looked at them until last night.

Q. Show me the ones for the cans.

A. I will show you for the Douglas Cannery. I have got it.

Mr. Paul: Look at it, counsel, and see if that isn't the ledger account. Here is a carbon copy of checks, bank schedules; here is some more.

Mr. Monagle: I don't know what it is myself.

Mr. Paul: Well, there is some more.

(Testimony of Sigmund Einstoss.)

A. There is $5119.00 paid to Douglas Canning Company by check.

Q. Well, I want to see your other checks too, Mr. Einstoss.

Mr. Paul: Sure.

The Court: Well, now, what is there in the record to show that this is chargeable against the Asps? I think there should be a ledger account to show that.

Mr. Monagle: There is nothing. That is the whole trouble. [35]

A. He never bought any cans himself.

The Court: Can the Douglas Canning Company prove that?

A. I suppose they can.

Mr. Paul: Bills of lading too.

A. No question about it.

The Court: As I say, all that should be reflected in a ledger account and it would show it quickly.

Mr. Paul: I think this is a ledger account myself. I am not much of a bookkeeper either.

The Court: We have been discussing now the condition of the account between the two for the past half hour, and there doesn't seem to be anything available here that would throw any light on it. It is just inconceivable that regardless of whether the operation was a profitable one or not that there wouldn't be something to show the state of the account between them.

(Testimony of Sigmund Einstoss.)

Mr. Paul: Counsel won't introduce it as an exhibit.

Mr. Monagle: I have a bunch of checks from S. Einstoss to S. Einstoss.

Mr. Paul: It is a statement of accounts for 1949, the first and second season, what the witness had in his hand.

Mr. Monagle: May it please the Court, counsel knows those aren't books.

Mr. Paul: Here is the ledger it was taken [36] from.

Mr. Monagle: I submit if he can get those statements from those books—just can't do it. It is only a fish-buying ledger.

Mr. Paul: Oh, no.

Mr. Monagle: I submit, if he can show in there, showing the purchase of any cans from anybody, why then I will concede the whole case.

Mr. Paul: It is your witness.

Mr. Monagle: Go ahead and show it to the Court. You say it is in there.

The Court: Well, you may continue your cross-examination to determine what the state of the account is or some other phase or aspect of the case.

Q. Now, as I understand——

Mr. Paul: Your Honor, I think we ought to have these marked as exhibits. I don't like to have them floating around the courtroom.

Mr. Monagle: When I get the books, I will introduce them.

Mr. Paul: Just so they don't float all over.

(Testimony of Sigmund Einstoss.)

Q. Did you or did you not bring your books and records of advanced items between you and Sam and Maude Asp with reference to the canning of fish?

The Court: You mean the books of original entry?

A. Books of original entry. [37]

The Court: The first time you make an entry on these particular records; not something you copied.

A. I didn't know what you exactly needed, and to the best of my knowledge I got everything you asked for. That is the way I told the bookkeeper, all records in connection with that transaction, and this is what he sent, whatever you call them. It doesn't look to me like the original books.

Q. Well, you know they aren't?

A. Yes, I know.

The Court: You can't use a substitute over objection. The only time a summary is allowed to be used is when the books are so voluminous that it wouldn't be practicable to bring them in the courtroom.

A. If your Honor will give us time, I will bring everything that I know what you want.

Mr. Paul: I think everything is here, your Honor.

Mr. Monagle: I don't think there is.

Mr. Paul: I don't like the insinuations. We have everything here.

The Court: Do you have the books of original entry or only copies?

(Testimony of Sigmund Einstoss.)

Mr. Paul: They look to me like books of original entry. They have got all sorts of items; cash advanced to Sam and Maude Asp.

The Court: But it seems to me there ought [38] to be some account like a ledger account in which all these things would appear in more or less summary form and tell the Court at a glance, or anybody else, the status of the account.

Mr. Paul: Here is the money that Oakson spent and what it was spent for.

The Court: In other words, you have all the records there or the books there, you might say, except the ledger account where everything would be sort of consolidated?

Mr. Paul: Yes.

The Court: Then why isn't the ledger account here?

Mr. Paul: I mean to say this is the ledger account. For instance, it has under expenditures for a particular boat all the items spent for fish purposes and oil——

The Court: But wouldn't that require a posting to the ledger account between the two of them? Otherwise it is not a ledger account.

Mr. Paul: I don't know if they make up that or just this kind of final statement.

The Court: If my knowledge of bookkeeping is of any value, I think that any business man can glance over his ledger account and tell what the status of the account with any particular customer or with anybody in the field is. He wouldn't look

(Testimony of Sigmund Einstoss.)

at half a dozen books and then spend hours digging it out.

Mr. Paul: We have the result of the records [39] the witness is so eager to identify.

The Court: Well, you haven't got anything such as a ledger account to which I have been referring. If counsel is satisfied with these component parts of it, I suppose he may examine them. He will have to do that.

A. Your Honor, may I make another statement. It so happened that I was sick in the hospital and that put me back taking care of this last year, and in the meantime this year's business come up. I didn't know such a thing was coming up. As far as the records, I told them to get everything in connection with it. I didn't mean to withhold anything nor do I. We have a bond for this year and it is still good. If counsel prefers, we will adjourn it and let him tell us exactly what he wants. No reason on my part—everything I say here is the truth.

The Court: You say everything you say is the truth and yet in the next breath you say you don't know anything about it because you personally don't keep them.

A. I personally don't keep them.

The Court: How can you say everything is the truth?

A. I mean my statement is true, no intent on my part——

The Court: When you make a statement that all these are true and then you say in the next breath

(Testimony of Sigmund Einstoss.)

that you don't know anything about them, you don't keep them, then your first statement can't be right. [40]

A. As far as I know, and as far as the bookkeeper knows.

The Court: As far as you know, but you don't know very far.

A. That is right. They should be. If there are any other records required, we can adjourn if your Honor permits and let him tell me what he wants or I will bring the bookkeeper. I don't know anything about records.

Q. Let me ask a question. You pay three bookkeepers and an accountant to keep records like that? A. I do.

Q. You are telling the truth that these are the only books and records you have; is that right?

A. This is the only books they sent me, and I asked for all in connection with the operation.

Q. How could you find out if the man took thirty thousand dollars if this is the kind——

A. I found out later.

Q. You have a regular ledger sheet on how much you paid out to Sam and Maude Asp, Tenakee Fisheries, and how much fish you got, and how much you got from the fish; isn't that true?

A. I can just repeat——

Q. I am asking if this is true or not.

A. I don't know anything about my books, never looked to speak of or know. I depended on my bookkeeper and [41] accountant. All these books you

(Testimony of Sigmund Einstoss.)

mentioned you want, I will have the bookkeeper come up.

Q. You were given a subpoena by the Court. Can you read—"bring all books and records"?

A. I asked for all the records.

Q. Didn't Marshal Hellan serve you with a copy? A. Yes.

Q. Doesn't it say "books and records"?

A. I misunderstood them.

Q. Is there anything there says "part of the books and records"?

A. I asked for all I knew of, and that is what I received.

Q. I want to ask you another question. Be sure you consider it carefully. Didn't Mr. Ziegler tell you that, when I phoned him last Friday or Thursday when you were there in Ketchikan, that I would take your deposition ahead of time so you could go south if you brought all your records and books according to the subpoena?

A. Mr. Ziegler told me at the time at a union meeting, and I was upset with all kinds of trouble with the union and I didn't pay attention to what he said or didn't say. All I was interested to know at the time was whether you would consent to a deposition and——

Q. You asked him to call me and then you didn't pay attention?

A. And I walked out when he called you. [42]

Q. You didn't pay attention to what he said?

(Testimony of Sigmund Einstoss.)

A. He said that the time was short. I have to go here anyway so it didn't matter.

Q. He told you to bring your books and records?

A. I don't know exactly what he told me.

Q. You won't deny he told you that, will you?

A. These books were here already before. I mean they were all wrapped up. I brought them last time and, when the case adjourned or whatever you call it, and I took them back with me to Seattle, and I asked for them again, and they sent them here the other day.

Q. You had those books here the last time you were here in court, did you, all these records?

A. Whatever it was.

Q. Then why was it that your attorney informed the Court that you had to get your records from the States and you couldn't go to trial at that time?

Mr. Paul: Just a minute, your Honor. Counsel is confusing this. The first setting requested by us was requested late because of the difficulty of the fishing season, and counsel asked for a second postponement, and that is the one we are going to charge him for his coming back to Juneau a second time.

Mr. Monagle: It wasn't the last one, may it please the Court. I think Mr. Einstoss just deliberately failed to [43] bring these books.

A. That is not so.

Mr. Monagle: He says he had them here the last time he was in court. The postponement at that time was because the fishing season was coming on

(Testimony of Sigmund Einstoss.)

and he had to get his books from New York, as I remember.

Mr. Paul: That is what he said.

Mr. Monagle: He testified he had them here all the time.

Mr. Paul: If counsel wishes, I will bring up the wrapping paper. I unwrapped them yesterday.

Mr. Monagle: He says he had them here last time. He ought to know. The ony way I know how to proceed is to make him get his books here. I don't think we should take a lot of phoney records, transcripts from books and records.

Mr. Paul: Your Honor, I made the suggestion to counsel, and I think it is a good one and I think it will save the Court's time. We have the original invoices, and one of them is on the Douglas Canning Company's stationery. It is impossible for us to make up any phoney statement from that. We have the cancelled checks.

The Court: That is all true, but counsel can answer that by saying that you didn't bring all records of that kind here. How would he know that all records of that kind were here? You might have six invoices, whereas there [44] might be ten in existence. There is no way of knowing it without a ledger account.

Mr. Paul: If there were ten in existence, that would be money owed Einstoss from Asp—a good deal larger.

The Court: Well, take the converse of the thing.

Mr. Paul: We are willing to produce a state-

(Testimony of Sigmund Einstoss.)

ment from the Douglas Canning Company. It is inconceivable that counsel would think that is a forgery.

The Court: I don't think the objection is that any of the records are a forgery or false or anything like that, but that they are incomplete, that the original records, or you might say the books of original entry so far as a ledger account is concerned, showing the status of the account between the Asps and the witness, are not here.

Mr. Paul: Well, I don't know anything about that, your Honor.

The Court: Well, it in incredible that there wouldn't be such an account complete.

Mr. Paul: It is not incredible to my mind. When you look at the final report, your Honor, why there are cash receipts and disbursements.

The Court: But where is the final report?

Mr. Paul: The witness had in his hand; the entire season.

Mr. Monagle: May it please the Court, I [45] haven't gone over every single item here, but I submit there is nothing in these ledger sheets here prior to September 30, 1949, and there is nothing in them after October 15, 1949. It can't be; it is impossible for them to be books and records that were kept of the transaction because he testified that Asp was packing fish for him the whole season, 1949. The season started in August, and the first season ended in September. This started September 30th. That couldn't be his books and records. It

(Testimony of Sigmund Einstoss.)

would be impossible according to his own testimony. It is either a worksheet or something that is gotten up afterwards or something copied from a book.

The Court: Is there anything here on Tenakee?

Mr. Monagle: I couldn't find anything. I might have overlooked it, but I don't believe so.

Mr. Paul: There is one there. Salt Sea Fisheries is the title of the page.

Mr. Monagle: I didn't see it.

The Court: Well, this is it.

Mr. Monagle: Does that take in the entire season?

The Court: You can look and see.

Mr. Monagle: Well, it starts October 7th, may it please the Court, 1949, and ended October 19th.

The Court: What is the first item there?

Mr. Monagle: Frank Jack, 2¾ H at $1.60.

The Court: Does it purport to be the entire account? [46]

Mr. Monagle: Well, the total is in the debit side, $694.71, and the balance. The credit, he has a credit item, $3702.00, and a debit balance, $694.71. The credit is 2468 cases at $1.50, October 16, 1949, at $1.50, a credit of $3702.00. He testified he agreed to pay $3.50. I don't know what that means. It doesn't cover the season 1949. It doesn't start until October 7th.

Q. Does that purport to be a record of your transaction with Sam Asp and Maude Asp, the page I am showing you?

(Testimony of Sigmund Einstoss.)

A. From what I heard you say, that must have been the second season.

Q. Will you explain this item, 2468 cases at $1.50? What does that mean?

A. It could mean two things, either cans, or it could mean so much advanced. I don't know.

Q. You don't know? A. No.

Q. If it was the cans, why would it be put in as a credit?

A. I don't know anything about books.

Q. In other words, if you advanced $3702.00 worth of cans or 2468 cases of empty cans, you would charge those to Sam Asp, wouldn't you?

A. I don't know how they kept the books.

Q. You wouldn't credit him for that, would you?

A. I don't know nothing about books. [47]

The Court: Did Asp return any cans?

A. He used my cans for all fish he packed. I shipped them out, and later on took them back at the end of the season, five thousand, Tennyson's a short distance from Tenakee, and others were taken to Sitka.

Q. When did the season end last year?

A. The first or second?

Q. Second.

A. October sometime; I don't know.

Q. Why would you be sending him empty cans, 2468 empty cans, on October 16th when the season is practically over—is over?

A. I can't answer that. I couldn't say if I did or not.

(Testimony of Sigmund Einstoss.)

Q. And besides that, why would you be sending him 2468 cases of cans when you claim you had five thousand there when the season was over?

A. Asp packed fifteen thousand cases.

Q. During the second season?

A. That is what he said, but he didn't anything of the kind.

Q. Why weren't the transactions for the first season set forth in your records here?

A. You can ask. It is the same story. I know nothing about records.

Q. Where are your records for the first season, your books, your ledger sheets? [48]

A. I asked for all the records. They are supposed to be here.

Q. I am talking about ledger sheets like this.

A. That is what I received, and I gave you all I received.

The Court: How many cases did the Asps pack that were accepted? Do you know that?

A. Not off hand, no; probably about six thousand.

The Court: Would it be in that account?

A. Should be, but I don't know whether it is or not. It is no use showing me records because I know nothing about records.

The Court: It seems to me, from his repeated statement that he knows nothing about it, that we are just wasting time here.

A. Can I ask your Honor, can I bring my bookkeeper from Seattle at my own expense and bring

(Testimony of Sigmund Einstoss.)

all the records—it will be agreed here today—if your Honor will let him explain to your satisfaction.

The Court: Have you anything to say in response to that suggestion?

Mr. Monagle: The only thing is they have been stalling this thing off since——

The Court: It would be only on terms. They would have to pay all the accumulated costs.

Mr. Monagle: I want to ask him just a couple more questions. [49]

Q. Would you know why the payment of five dollars to Billy Miller was charged to the Asps on this account? A. No.

Q. Do you know why $288.08, a check paid to Pete James, was charged to them?

A. Because my man had instructions not to give Asp too much money, and he paid out to people who worked for Asp and charged to him. That is what I believe it was.

Q. You don't know? A. I wasn't there.

Mr. Monagle: I guess that is all we can do, may it please the Court.

Mr. Paul: Subject, your Honor, to any showing of materiality, I think the records here and the effort of the witness to get all his books and his reasonable response to the subpoena and everything what we have here already merely goes to prove what the ledger sheets would show anyway if there are other ledger sheets.

The Court: I think counsel is entitled to a ledger account.

(Testimony of Sigmund Einstoss.)

A. How about the possibility of the bookkeeper——

The Court: The big obstacle, as I see it, here is that the witness doesn't know anything about the books.

Mr. Paul: It can be secured, your Honor, by looking at the cancelled checks. [50]

The Court: My answer to that has been all along that, while they speak for themselves as far as individual transactions are concerned, there is nothing to show a complete account. There is nothing to show that that is all the invoices or checks or anything else. An account kept contemporaneously, or nearly so, as accounts of that kind are kept, would certainly be the account to produce here.

Mr. Paul: I thought we were pretty much limited to who owned the cans; that is, only two items.

The Court: You mean the eighty-five cases of canned salmon?

Mr. Paul: No. The empty cans.

The Court: What was it that was attached? The empty cans or——

Mr. Paul: The full cans were attached ultimately. But it started out with Asps agreeing to furnish cans. Actually Einstoss furnished them and deducted $3.50, the cost. The Douglas Canning Company is one item, and there is a check in payment, and there were further cans bought by Einstoss from the Continental Can Company.

The Court: But wouldn't the fact as to who had

(Testimony of Sigmund Einstoss.)

any right to the cans there depend on the final settlement between them?

A. There was no final settlement.

The Court: There is no way of ascertaining [51] that that I see.

Mr. Paul: The Witness said there was no final settlement. He just gave up.

The Court: But counsel isn't satisfied with that. He wants the records that would corroborate the witness.

Mr. Monagle: In other words, the books are just part of the case. We can prove that Asp sold fish from that cannery, that everything packed at that cannery didn't go to Einstoss regardless of what he testified on the stand. This is just part of the case, the books.

Mr. Paul: What does that go to prove? That Asp is a liar and cheating Einstoss too?

Mr. Monagle: No. It goes to prove his books are wrong.

Mr. Paul: If there is anything more, we will furnish them, your Honor. The accumulated cost, I don't think will amount to very much.

Mr. Monagle: Considerably. We have a hundred cases of salmon——

Mr. Paul: Accumulated cost of delay, up to tomorrow afternoon. In other words, we have a day and a half accumulated cost; that is all.

Mr. Monagle: You mean if all the books are here tomorrow, you mean.

Mr. Paul: I can call them up. [52]

(Testimony of Sigmund Einstoss.)

A. Let me correct you. Who I want is the accountant. You will know what he is talking about.

Mr. Paul: Do you think he can get on the plane tomorrow?

A. I don't know if he can. Let's get a week's time at least.

The Court: Well, it seems to me, if I recall the rule correctly, that whatever expense a party is put to by reason of having to grant a continuance, is chargeable.

Mr. Paul: That is right. If there are further books and if it requires an extra day and a half to get them here, the extra expense would be a day and a half.

Mr. Monagle: I don't care about the day and a half. If the Judge goes to Ketchikan before the books are here, it will be a month or six weeks, and we have one hundred cases of salmon under attachment on which we are paying storage every day.

Mr. Paul: What has that to do with us?

Mr. Monagle: Part of the expense of the case.

Mr. Paul: Oh, no. You got a default judgment against Sam Asp and you can sell that stuff any time you want to. You could have sold it months ago.

The Court: We don't need to settle the matter of accrued costs now, but it is something that will have to be paid because of the continuance.

A. Your Honor, may I make a statement? The cost per case [53] may be three or five cents a month and, if there is one hundred cases, it can be three or five dollars. We will pay it.

(Testimony of Sigmund Einstoss.)

Mr. Monagle: Not on the City Dock.

A. I suppose it is ten cents.

Mr. Paul: Will we get all our papers back or are they going to be introduced as evidence?

The Court: Well, maybe they better be marked for identification or left with the Clerk if they ultimately are coming into the case.

A. I want to be frank. The attorney doesn't understand. I am going to call up as soon as I get back to the hotel and try to get the accountant here, but I don't guarantee that it will be a day and a half. Maybe he can't get here for a week though.

Mr. Monagle: We should have a definite time. This has gone on over a year now.

The Court: The Court can't tell when it will be here; I think around the first of November unless they send some cases down from Anchorage for trial down there.

Mr. Monagle: Could we put it this way? It is understood that the subpoena, Mr. Einstoss is still under subpoena and will appear on notice to his attorney.

The Court: The Court has the authority to order anybody in the courtroom to appear at a certain time. [54]

Mr. Monagle: Yes.

The Court: That will be the order.

Whereupon, the hearing was recessed; and thereafter on the 23rd day of January, 1951, at 10:00 o'clock a.m., at Juneau, Alaska, the above-entitled cause came on for further hearing, the Honorable

George W. Folta, United States District Judge, presiding; the plaintiff appearing by M. E. Monagle, his attorney; the garnishee-defendant appearing by William L. Paul, Jr., his attorney; and, respective counsel having announced they were ready to proceed, the following occurred:

The Court: Well, does anybody remember where we left off when we were on this case before?

Mr. Paul: As the Court stated, additional time in which to produce more records, and I stated to the Court that I thought we had them all, but on further consultation with Mr. Einstoss' accountant I find there are a few more records and have him here to identify them, and on the additional point also of justifying what has already been handed in to to the Court, and he is prepared to do that, too.

The Court: Now, what has already been what?

Mr. Paul: There are a quantity of records that have already been handed to the Court and are on the Clerk's desk.

The Court: When were they left with the Clerk?

Mr. Paul: In response to a subpoena.

The Court: When? [55]

Mr. Paul: Four months ago, I think.

The Court: Well, were they here at the time of the last hearing?

Mr. Paul: Yes; but they are, in the condition they are they were hardly intelligible to counsel, and Mr. Ramsey is here to explain those too.

The Court: I suppose it is your move now to put Mr. Ramsey on the stand.

Mr. Paul: Yes, indeed.

ROBERT L. RAMSEY

called as a witness on behalf of the garnishee-defendant being first duly sworn, testified as follows on

Direct Examination

By Mr. Paul:

Q. Will you state your full name please?

A. Robert L. Ramsey.

Q. What is your occupation?

A. I am a C.P.A. in the State of Washington.

Q. How long have you been a C.P.A.?

A Since 1937.

Q. You work for S. Einstoss?

A. I don't work for him. I have done work for him but I am not an employee of his.

The Court: You mean you are independent?

A. I am independent; yes, sir.

The Court: You do work for him just like you do for anybody who calls you or employs you for a specific purpose? A. Yes, sir.

Q. How long have you been doing this work for Mr. Einstoss?

A. About the past three years, approximately.

Q. And how often would you be called upon? What was the arrangement for this work?

A. Whenever he calls upon me, and I have some things I do for him whenever he wants, sending reports to New York.

Q. What does it consist of?

A. The reports to New York are usually a trial balance of his Seattle accounts which I send to the

(Testimony of Robert L. Ramsey.)

home office in New York and certain tax returns and reports for his property in various states.

Q. All tax returns?

A. All except the Federal Income Tax Return which is prepared in New York by a firm of accountants there.

Q. Would you say once a month?

A. At least that. There has been a month or so that we missed, but generally speaking that is true.

Q. Does he call you or do you just show up?

A. He at times calls me, and at other times I know that certain things are coming up and I go down and do them because he is not there all the time. In fact most of the time he is absent.

Q. What access do you have to his office?

A. I have access to it all the time that it is open; I don't have a key to the door; but during normal working hours.

Q. With respect to the records, what access do you have?

A. I have complete access to them.

Q. Are you sure you have complete access?

A. Yes.

Q. How are you sure?

A. Well, all the records that are in the office, I am privileged to go to them. They are all in the files.

Q. Isn't anybody there to direct what records you can get or prohibit you?

A. He has some girls and a bookkeeper. They

(Testimony of Robert L. Ramsey.)

know where they are, but I have the privilege of going and getting them.

Q. About four months ago, Mr. Ramsey, Mr. Einstoss was required to produce and deposit with the Clerk of this Court all his books, papers and records in connection with his business arrangements with Sam Asp and Maude Asp in the Salt Sea Fisheries operation. Who was the one that actually gathered those records together?

A. I was.

Q. And what was the occasion for gathering them together? Did you get a telegram or something like that?

A. My recollection is it was either a telegram or a phone [58] call to his bookkeeper, and he in turned called me in, and I gathered such records as I could find there and sent them to Mr. Einstoss.

Q. When you did get those together, did you miss anything?

A. Yes, I did. Apparently there was a misunderstanding as to the purpose of them, and certain ones I did not know were required and did not get sent up here.

Q. Just what? Have you brought them with you now?

A. Yes. I brought some additional papers and I brought Mr. Einstoss' general ledger which is this bunch of papers.

Q. Marked "General Ledger 1949 to 1950"?

A. That is right. His fiscal year ends July 31st each year.

(Testimony of Robert L. Ramsey.)

Q. So this would be August 1, 1949, to August 1, 1950? A. That is correct.

Q. What else have you brought?

A. This paper file and records which had to do with this matter.

Q. These are all the papers you have?

A. As far as I know.

Q. I see on the top here same papers marked "Tenakee, Summer" and also one marked "Schedule A". Is this the first time these have been in court?

A. No. Those were taken from the court's file. There is a receipt. I noticed in the file the other day a duplicate and a receipt where you removed them. [59]

Q. The others consisting of bills of lading, paid checks, some invoices for reconditioning salmon, you are now producing? A. That is correct.

Q. And where did you get these?

A. From his files in his office.

Q. Do you think you have missed anything?

A. I really don't know. I don't think so.

Q. Now, calling your attention to what was in the court file already, Tenakee, Summer, estimated on a basis of 4500 cases, have you had an opportunity to go over the material that you are now producing and what was in the custody of the court already to determine whether Tenakee, Summer, is accurate or not? A. Yes.

Q. And what conclusion do you reach?

A. Generally speaking it was accurate, but there were some changes necessary to revise it on the

(Testimony of Robert L. Ramsey.)

actual cases produced. That was on the basis of 4500 cases. Actually there were slightly less than that.

Q. How did you verify your result of Tenakee, Summer?

A. From the records I brought and those there. There were documents substantiating the information that was on that report. There was one schedule that was incorrect and which I revised. [60]

Q. You are mentioning now Page 3 of Tenakee, Summer? A. That is right.

Q. What is the matter with that page?

A. Apparently the man who prepared it has some items which were credited to Sam Asp and which are merely a breakdown of some advances which are charged to him. I have eliminated those from my revised report.

Q. To eliminate duplication?

A. Duplication of those items.

Q. With respect to Schedule A which was in the custody of the Court, have you made a similar examination of that?

A. I looked at those and made a similar examination. That is complete as it stands. I didn't have to revise that at all.

Q. Have you worked up your examination on Tenakee, Summer, and also Schedule A so that it will reflect the entire 1949 operation with Sam Asp.

A. Yes.

Q. You have copies of that available, have you?

A. I have my manuscript copy and a copy; yes.

(Testimony of Robert L. Ramsey.)

Q. Let's see one if you please.

Mr. Paul: I am about to question the witness on this work.

Q. Now, calling your attention to Page 3 of this 1949 combined statement, I see on the bottom "Balance Due S. Einstoss, [61] $131.86". I take it from your answers that that is correct.

A. To the best of my knowledge.

Q. What about the oil bill?

A. I do not have any information about that oil bill, although I know there was an amount due the oil companies which Mr. Einstoss had guaranteed to the oil company which was not paid by Mr. Asp, and Mr. Einstoss subsequently paid it. I do not know the amount of it.

Q. Whatever the amount, it would increase the amount due to S. Einstoss?

A. That is correct.

Q. Now, with respect to all the entries on this combined statement, were you able to find vouchers or paid checks, receipts, indicating that the money was actually expended?

A. Most of them, except for two advances for payroll and a number of small items which were under twenty-five dollars: there were not receipts in the file.

Q. For these number of small items describe generally what the characteristics are of them and whether it would be unusual for, in this type of operation, for those to be missing.

A. They were small items, and I don't think it

(Testimony of Robert L. Ramsey.)

would be too unusual. Twelve dollars and eight dollars, I see going down the line. One was for whiskey for fishermen. Probably [62] no receipt could be obtained for that. That amounted to nine dollars, and I am not surprised there were no receipts in the file for it.

Q. Have you ever had occasion to examine Mr. Einstoss's business operations to determine whether the 1949 operation was typical?

A. Yes. That is a typical operation. He advances money for the operation and sends some man out there to be in charge of it, and the man pays out money, and he in return receives the product, either canned salmon or frozen fish, and he is not too concerned with the details of it as long as he receives what in his mind is sufficient canned salmon or fish.

Q. This, marked Tenakee, Summer, is marked "estimate". Why wasn't there ever a final account made of that?

A. I believe there wasn't because, when the season was over, Mr. Einstoss determined he did not owe Mr. Asp anything and he wanted no more work done on it.

Q. It was a case of spending more money to discover you lost money?

A. That would be his thinking on it.

Q. With respect to making up the income tax reports, does the report claim a loss?

A. The loss would be reflected in the books because the total advances were charged to fish pur-

(Testimony of Robert L. Ramsey.)

chases and, since that [63] was the total money he paid out, that would be his total cost.

Q. When ordinarily would the income tax reports be made up for the 1949 operation?

A. Two and a half months after the close of the fiscal year which would be after July 31st.

Q. That would be August and September and up through the middle of October, 1950?

A. That is right.

Q. When the time limit was to have the income tax report made up? A. That is right.

Q. Do you know if they were made up?

A. No; they were not made up at that time, because unfortunately that is the height of the fishing season and the office force is busy and they usually get an extension.

Q. Do you know if there was an extension in 1950?

A. Yes; there was. It was completed January 15th of this year.

Q. January 15, 1951. There has been some testimony about Mr. Einstoss' unfamiliarity with his bookkeeping system. Do you know anything about his unfamiliarity with his bookkeeping system?

A. Mr. Einstoss, I would say, is not familiar with the technics of bookkeeping or accounts, although he is able in [64] his mind to form a pretty accurate answer to what his profits or his losses are in any one operation.

Q. What was the occasion for your starting to work for Mr. Einstoss?

(Testimony of Robert L. Ramsey.)

A. He had some trouble with one of his accountants. In fact the man embezzled some money and he called me in to try to find out the amount he embezzled.

Q. Do you know what the amount was?

A. In the neighborhood of thirty thousand, although we never could tell exactly.

Q. Was there any prosecution of the accountant for that? A. No.

Q. Was there any evidence from the accountant that he had embezzled thirty thousand dollars?

A. I believe Mr. Einstoss has a written confession from the man.

Mr. Paul: At this time, your Honor, we will produce in evidence the combined statement of the 1949 operation about which I have been asking the witness here very briefly.

The Court: Any objection?

Mr. Monagle: We have no particular objection, except that they are not original records. If he wants them for information, it is all right; for his information, it is all right. The subpoena called for original books and records, may it please the Court, and of course that is what I want. [65]

Mr. Paul: The original books and records are hardly intelligible unless we have someone to work them up. If counsel wants to examine him, the witness, on all the items to justify the items in the combined statement, we are now offering——

The Court: What does the statement show? That is not clear to me yet.

(Testimony of Robert L. Ramsey.)

Mr. Paul: It shows that if Einstoss owns the 86 cases of salmon that is in controversy here and given credit, still Asp owes Einstoss more money.

Mr. Monagle: I grant that, if he owns them, but that is exactly what the case is about.

Mr. Paul: I think what we are trying to do in this case, your Honor, is to rebut the assumption or possibility that Einstoss made some arrangement to leave that salmon with Asp as credit or payment from money due from Einstoss to Asp. We are trying to show the opposite exists. Even if Einstoss took all the 86 cases of salmon, that he still has more money coming from Asp. Now, the evidence on the part of the Asps is that the 86 cases belong to Einstoss.

The Court: Would this table show that?

Mr. Paul: This table includes the 86 cases of salmon.

The Court: But would it show what you say it shows? If you are going to introduce anything like that, you ought to [66] state what it shows, otherwise the Court has to examine it and waste a lot of time trying to determine what it does show.

Mr. Paul: It shows that the 86 cases is incuded in the computation as owned by S. Einstoss. It shows there cannot possibly be any arrangement by which Einstoss would have given the 86 cases to the Asps in settlement of their account, for instance.

The Court: Because of the fact that there is a balance due Einstoss?

(Testimony of Robert L. Ramsey.)

Mr. Paul: There is still a balance due, even including the 86 cases of salmon.

The Court: Then, as I understand it, you contend the fact there is a balance due Einstoss proves ownership of the salmon in Einstoss?

Mr. Paul: That, coupled with other evidence in the case, does, your Honor. Mrs. Maude Asp admitted to the Marshal at the time of the levy that this salmon belonged to Einstoss. I don't know what other proof we can offer to show that this belongs to Einstoss. The defendant says so, and we say so and prove that there is no possibility, no likelihood, no factual situation exists which would cause Einstoss to transfer ownership to Sam Asp or permit Sam Asp to claim some lien on them.

Mr. Monagle: I don't agree, may it please the Court, that the defendant informed the Marshal they belonged to Sam [67] Asp. The defendant took the Marshal to the fish which were segregated from all other fish out there. The Marshal so testified.

The Court: How would that be admissible against the plaintiff?

Mr. Monagle: It isn't. The other thing, the reason I demanded the original records, it shows right on the face—Mr. Einstoss swears in his affidavit that "on or about August 18, 1949, the affiant and defendants settled their accounts, and affiant paid in full the defendants for any and all services performed under said contract for 1949." Now, he is bringing in here bills and stuff that show on their face they were paid after that. If all the accounts

(Testimony of Robert L. Ramsey.)

were settled, how is it this fish was packed after that date? Another item here, the contract itself shows, "all expense pertaining to chartering tenders, wages for the tenders, is for your account." That is from Sam Asp to Einstoss. The first item, "Tender service, boat 'Wilson', $2026.99".

The Court: You mean charged against Asp?

Mr. Monagle: Yes. "Boat 'Robert Barron', $1,458.98." There is $3,485.97 charged as credit against advances here which are not properly accountable according to Mr. Einstoss' own sworn affidavit. That is why I don't see why we should be bound by some conglomeration of records of Mr. Einstoss'. All the accountant is testifying to is what he got from Mr. [68] Einstoss. I want to see the books, the original entries.

Mr. Paul: Are there any more books or records?

A. No, sir. The books and records are in those files that were turned over there.

The Court: As I understand it, you object to the introduction of this, or are you just calling attention to it?

Mr. Monagle: I object. It doesn't answer the subpoena at all.

Mr. Paul: We have answered the subpoena, and now we are going on continuing to prove our case.

Mr. Monagle: I would like to ask him a question, your Honor.

(Testimony of Robert L. Ramsey.)

Cross-Examination

By Mr. Monagle:

Q. You mean to say Mr. Einstoss has no other books and records except what are there on the Clerk's desk?

A. Concerning this matter, he has no other records.

Q. In other words, he doesn't enter these in any original, make any original entries of these bills of lading and costs and expenses; is that correct?

A. Well, no, it is not correct.

Q. Does he or does he not make original entries in books and records? A. He does. [69]

Q. Where are they? A. Right there.

Q. Show me the original books.

A. There is one more file. What happened to it?

Mr. Paul: It must be there.

Q. You mean this?

A. That is right. This is Mr. Einstoss' general ledger where he keeps track of all his accounts for the year. And these sheets are the sheets for this particular salmon received in Seattle.

Q. Where are the books that these sheets are taken out of?

A. This is the book—I mean, there is a black binder. I didn't bother to bring it in the airplane, to save space.

Q. You didn't bring this, did you?

A. Yes, sir.

Q. Now, these are the only books that Mr. Ein-

(Testimony of Robert L. Ramsey.)

stoss had pertaining to his fish operations at Tenakee during the year of 1949; you are swearing to that?

A. Not those two; these besides. There is in here a ledger for the fall season.

Q. And now, these are all the books of account, books of record, that S. Einstoss keeps and that you ever audit in making reports or tax returns or anything else, Federal or otherwise?

A. No. [70]

Q. What other books are there?

A. There is a cash receipts and disbursements.

Q. Where is that? A. In Seattle.

Q Why wasn't that brought up?

A. I did not know it was required.

Q. What were you told to bring?

A. The papers covering the Sam Asp case.

Q. Just the papers? Nobody told you to bring all the books?

A. May I explain? This cash receipts and disbursements journal would only have five items, would have a limited number of items, which would affect this case. It would be entries of the checks for the operation, and I have copies of those checks, so in that book it would be merely an entry, the amount and the date, and there is copies of those checks in here.

Q. Did you personally enter those in the book?

A. I have very seldom made any entries in Mr. Einstoss' books.

Q. When you say these are exact copies, you are

(Testimony of Robert L. Ramsey.)

just assuming from what you were told by the bookkeeper; is that correct?

A. No, I don't think so, because I know that his books are in balance and those checks are included in the bank account and, therefore, they should be on the account.

Q. Should be. But isn't that the way Mr. Einstoss claims he lost money by another [71] bookkeeper? A. I don't believe so.

Q. If his books are correct, he should have missed that?

A. I don't understand your question.

Q. Mr. Einstoss testified and you testified he was defrauded out of many thousands of dollars?

A. Yes, sir.

Q. There must have been something wrong with the books or he couldn't have got away with it?

A. Actually that would not be the cause of it.

Q. Was it or wasn't it?

A. The entries in the books were not the cause of it. The man obtained checks payable at the bank and in turn got them cashed at the bank. The checks were entered.

Q. Can you tell me why some of these entries were in here, the last file I gave you?

A. You mean the one I just typed up?

Q. No.

A. I just brought those down from Seattle. I don't believe you have ever seen those before.

Q. No; but I think I know some of the stuff that is in here if I can find it. Will you tell me

(Testimony of Robert L. Ramsey.)

why a bill to Keller Fishing and Packing Company, Sitka, Alaska, $1140.31, is charged against the account of Sam Asp?

A. Well, it isn't charged against Sam Asp.

Q. Does it appear in these books? [72]

A. No.

Q. What is it in here for?

A. I brought that document up for information about cans.

Q. Where is the books that show this entry of that item and the payment of that item.

A. That book that particular item is entered in is in Seattle. It doesn't have anything to do with this case other than for my information.

Q. If it doesn't have anything to do with it, why did you bring it? It reflects the cost of cans, doesn't it? A. Not for this operation.

Q. For what operation?

A. This particular one is at Sitka.

Q. What information could you get off of this bill of lading and invoice? What did you need that for if it had nothing to do with the operation?

A. To make calculation of cost in cans, and I brought the invoice, if I needed it. As I mentioned, that file, you had not seen that before.

Q. As a matter of fact and truth, those cans were sent and billed to Sam Asp, Tenakee Fisheries, and then sent to Sitka, taken away from the cannery after they were charged to him?

A. I don't think so.

Q. Isn't that why you were told to check these?

(Testimony of Robert L. Ramsey.)

Why was it [73] you brought these or took these cans into consideration if they had nothing to do with the operation?

A. I didn't take them into consideration.

Q. What did you bring them for?

A. I previously told you I brought them for reference.

Q. Reference for what?

A. If I needed the prices of cans during that time, I could look at that and see what they cost.

Q. And going through this—Northwest Reconditioning Company, Keller Fishing and Packing Company, Smith Tower, Seattle, Washington—what reference does that have?

A. It shows the cost of recondition salmon.

Q. It says right on it from Deer Harbor?

A. That is right.

Q. Not Tenakee at all?

A. It has nothing to do with this particular operation. For reference only.

Q. Now, then, this bill of the Keller Fishing and Packing, or check to T. H. Calvert, what did you use that as reference for?

A. Mr. Calvert was an accountant for the operation at Tenakee for Mr. Einstoss.

Q. And what does that purport to be?

A. I think it is his salary check.

Q. Here is another check, Continental Can Company, $764.56, [74] for cans sold to Keller Fishing and Packing Company, Sitka, Alaska. Where does that appear in these records?

A. Same situation as the previous ones.

(Testimony of Robert L. Ramsey.)

Q. In other words, you needed duplicate copies to find out the price of the cans? A. No.

Q. What is the difference between the two invoices?

A. I don't think probably any difference, but shows two sales at the same price.

Q. You needed two so you could take two invoices to make sure the price was right on each one?

A. That is what was there.

Q. Now, here is a check to Northwest Reconditioning Company for $844.00 for reconditioning 421 cases and 28 cans of fish. Now, where does that appear in the books?

A. That has been charged to Sam Asp on this analysis of the account. It would be charged to reconditioning of salmon.

Q. Will you show me where that is?

Mr. Paul: It is under "R", reconditioning.

A. This one appears to be a different situation.

Mr. Paul: Oh, I see.

A. This particular check was paid by the Keller Fishing and Packing Company, which is an affiliate company of Mr. Einstoss', and was charged on their books and then from there transferred to Mr. Einstoss' books and would appear [75] as a credit in this ledger here.

Q. Where?

A. He would credit Keller Fishing and Packing for making this payment for him.

Q. I want to see where it is credited.

A. It is presumably in this total, $109,122.36.

(Testimony of Robert L. Ramsey.)

Q. Where is the book that segregates and shows these charges?

A. I am sorry; that would be in Seattle.

Q. You don't have that? A. No, sir.

Q. Can you tell me where this check is charged? Strike that. Does this check to Conway Dock Company, January 17, 1949, appear in these records?

A. No. That would be prior to this ledger.

Q. Is that all the bills of lading that were given to you in connection with this matter?

A. No. These files here in the court have some more bills of lading; in here.

Q. Now, here is a bill of lading here for a shipment of cases of cans to M. Soley at Sitka, Alaska, on the "Forester" from Tenakee. Will you show me where there is credit allowed for those cases in these records? That is a copy. Here is the duplicate original.

A. Well, I don't understand your question, sir.

Q. Well, there was 480 cases of empty cans made up and 10 [76] cases of lids sent on the "Forester" from Tenakee to M. Soley, Sitka, Alaska. Will you show me where there is any credit allowed for those cans?

A. No; I can't, because there wouldn't be any entry made for transfer of those cans.

Q. Why wouldn't there? They were Sam Asp's cans, and he is charged with them on this book.

A. No. I don't think they were Sam Asp's cans. They were Mr. Einstoss', and he transferred them from Tenakee to Sitka.

(Testimony of Robert L. Ramsey.)

The contract provides that Sam Asp be charged with the cans, and they are charged to him in the original purchase in the book? A. No, sir.

Q. Where are the records that show the can purchases?

A. The can purchases would be in here.

Q. I just asked you, and you said they wouldn't.

A. You didn't ask me that, sir.

Q. Well, go ahead.

A. I think that would be in here. To the best of my knowledge the cost of the cans would probably have been charged to the purchase of fish.

Q. The cost of cans was charged to the purchase of fish? A. That is right.

Q. Weren't there checks issued for the cans?

A. The checks were issued by this other company, Keller [77] Company, because they have the contract with the can company.

Q. Who is Keller Fish Company?

A. That is a corporation owned by Mr. Einstoss which normally does all the canning of salmon.

Q. Actually it is S. Einstoss?

A. That would be in a sense correct.

Q. Can you explain, as a certified public accountant, why he runs those kind of purchases through the other books and then charges them against Sam Asp on this book without giving any breakdown to show where payment was made and what he was buying and what Sam Asp was being charged for?

(Testimony of Robert L. Ramsey.)

A. First, nothing was charged to Sam Asp on those books.

Q. What do these books purport to be?

A. That is Mr. Einstoss' general ledger.

The Court: What does it purport to show?

Q. I call your attention to the top of the page—purchases, frozen and fresh fish. That is the top of the page? A. Yes.

Q. What do the books purport to show?

A. I would like to explain. When Mr. Einstoss starts an operation, he advances money to pay for the cost of the fish, and those advances are charged to that account, and there is no account set up as Sam Asp. After the season is over the bookkeeper comes down with what he did with the money, and then he settles with the man in charge of [78] the job. But at the start it is charged to that account—fish purchases.

Q. Now, in August, 1949, do you mean to tell me that the fish purchases at the Tenakee cannery was 191,275?

A. Not for Tenakee. It is for every place.

Q. You told me all you brought were the books that pertained merely to this situation.

A. No. I brought the records for the situation. I brought Mr. Einstoss' general ledger.

Q. As accountant, I want you to point out to the Court what part of that amount was in payment of fish to Sam Asp's cannery.

A. The only way I could tell you that would be to refer to the schedule.

(Testimony of Robert L. Ramsey.)

Q. Where in the books can you show the breakdown?

Mr. Paul: I think the witness has already answered that. He says there is no breakdown except by going to the original bills and making up a separate statement. We have offered that separate statement in court, and it shows some forty-four thousand fish purchased.

Mr. Monagle: I want to see how he arrived at that from these books. How would he justify it if the Internal Revenue asked? I want to find out where the fish were bought.

A. I would show them the schedule.

The Court: What schedule is this you are talking [79] about now?

Mr. Paul: The one I am seeking to have introduced in evidence, your Honor.

Mr. Monagle: I want to know where he got those figures that he put on that schedule. He got them from books in Seattle. A. No.

Q. Show us.

A. If you will bring the schedule, I will.

Q. I don't want to see the schedule. I know you made that.

Mr. Paul: Look at the original schedule—the Clerk has it right here—of fish purchases. That is what we are interested in, is it?

The Court: Well, who kept these records, or made them, from which the summary was made?

A. Well, the man that was in charge of this operation for Mr. Einstoss at Tenakee made the

(Testimony of Robert L. Ramsey.)

summary of the money advanced by Mr. Einstoss.

The Court: From what did he make the summary? A. From these papers here.

The Court: He kept those at Tenakee and then took them down to Seattle? A. That is right.

The Court: And made the summary?

A. Right. [80]

The Court: The summary that is now offered in evidence?

A. The summary which was here previously and which I revised and which is now offered in evidence.

The Court: We have no one here who can testify that these records brought down from Tenakee are correct. You have to accept them as correct without knowing whether they are correct; isn't that so?

A. No. I would say they are correct because of cancelled checks and documents supporting the payments, bills and so forth.

The Court: The instruments may be genuine in a sense but, so far as bookkeeping is concerned, how do you know they have been entered properly or anything else?

A. We can account for the total advances made by Mr. Einstoss for the operation.

The Court: Doesn't that depend on somebody else's bookkeeping? A. Yes, sir.

The Court: So you are here without any personal knowledge of how this thing is made up?

Mr. Paul: That is not the situation at all, your Honor. There are eight items were advanced to the

(Testimony of Robert L. Ramsey.)

agents of Einstoss who were actually conducting the operations, a total of $60,000.00, plus a little refund—$61,123.00. Now, the [81] only trouble that Einstoss is confronted with is finding out where that money went to, and then you go to the original receipts that are produced in the regular course of business, and they are now before the Court, and nine-tenths of them have been already identified by Einstoss, and it balances out. It comes to sixty-one thousand dollars.

The Court: But my point is, is there any way of identifying any of these individual documents with these advances? It seems to me it would take the person who kept the original records to do that.

Mr. Paul: Well, the original records are paid checks and receipted bills.

The Court: But what is there to identify these transactions? I am not questioning that they may be original records. But what is there to identify them with these advances, for instance?

A. Here is the check covering one typical one. No. 6476, $5,000.00, issued to Marvin Rubenstien.

Mr. Monagle: But that isn't Sam Asp.

The Court: What does that explain? That isn't intelligible to me.

A. Mr. Marvin Rubenstien was Mr. Einstoss' representative there, and he disbursed these funds which he received from Mr. Einstoss.

The Court: That doesn't go to my question. [82] My question is, how do you identify any of these papers with the advances?

(Testimony of Robert L. Ramsey.)

A. Identify them because——

The Court: Well, for instance, you advance $5,000.00 and then it becomes a matter of showing what became of the $5,000.00. Then you have to take somebody else's papers for it; you have nothing to do with making it up? A. That is right.

The Court: You have the situation, as I said a moment ago, where the witness doesn't have knowledge that the records themselves are correct.

Mr. Paul: We would have to have thirty or forty people up here to say, "Sure, Sam Asp ran up a bill at the Baranof Hotel about such and such a date and cost so much money."

The Court: You don't need to say thirty or forty people. It seems to me that any kind of a business has somebody who does the original entry work. Now, it seems to me that he would be the one to be here and not somebody who makes up a summary from the original entries.

Mr. Paul: My point is, even going beyond that, if we had Marvin Rubenstien here, it wouldn't be sufficient because payments were made direct to Sam Asp. For instance, the payroll account to Sam Asp, what does Marvin Rubenstien know about that? [83]

The Court: Well, you mean to say that this is such a complicated business that it takes a half a dozen or more bookkeepers to do the original entry work on these books?

Mr. Paul: I think, your Honor, that is a situation that always exists in bookkeeping. Bookkeeping depends upon the regular course of business. Things

look genuine so they are entered in the books or an analysis is made up and, until something suspicious arises, why things go along.

The Court: More than that, the law requires that the person who testifies from records knows that they are correct even though he had nothing to do with making them. That isn't the situation here. Nobody here can testify that these records are correct.

Mr. Paul: Certainly no one is testifying that they are incorrect.

The Court: It has to be the positive thing, that they are correct. That is a prerequisite to their admissibility.

Mr. Paul: I think we can gain the inference, from the fact that Sam Asp made no objection, that they are correct.

The Court: But isn't Jim Cole the one whose objection has to be heard, not Asp? Cole isn't bound by Asp.

Mr. Paul: What has Cole got to do with it, your Honor?

The Court: Isn't he the one that is trying to get [84] a judgment satisfied here?

Mr. Paul: I know, but primarily the business was between Asp and Einstoss. If anybody stands to gain, it is going to be Sam Asp, in making an objection.

Mr. Monagle: Oh, it certainly isn't.

The Court: Unless Sam Asp is subject to a judgment or something, he is not going to stand to gain by it.

Mr. Paul: If the judgment is reduced, he certainly gains by it.

Mr. Monagle: It won't reduce the judgment any by making them bring any honest, correct books of account.

The Court: It just seems to me we have muddled around here for a long enough time now on this case and we never seem to have the records or the witnesses we ought to have. Now, the big objection that I see to it now, particularly in view of the position taken by counsel here in which he questions the authenticity or the correctness of these records, is that the first hurdle is their admissibility, and they don't meet that test because you haven't got anybody here that can testify they are correct. By that I don't mean that you have to have the person who made them, but you have got to have somebody to testify they are correct.

Mr. Paul: Just to keep these records. I don't think we need to do that, your Honor.

The Court: The law requires that the person by whom [85] you seek to introduce records of this kind has got to be able to testify that they are correct of his knowledge.

Mr. Paul: No, not of his knowledge, with all due respect to the Court. Our testimony is that these records were received in the ordinary course of business, and I think testimony to that effect is sufficient.

The Court: I don't think so. That is not my recollection of the law. But if there is going to be any more trouble about these records and their in-

completeness, the only recourse the Court has is to refer it to some accountant. I can't be bothered with this thing piecemeal indefinitely.

Mr. Monagle: They showed by their own evidence, may it please the Court, that half the information is in other books which aren't here, and it is done purposely, I submit.

Mr. Paul: Oh, it is not. The witness testified that the daily cash book is not here, that consisting of eight items, and the eight items are right here.

Mr. Monagle: The subpoena said to bring it.

Mr. Paul: I submit it is an immaterial variation.

The Court: Where counsel questions everything in the way that he does, and he has a right to do that, the books should have been produced, and there was plenty said on that very thing when the case was continued before, the necessity of producing all the records.

Mr. Paul: We thought we produced everything, your [86] Honor. Now, of course I say it is an immaterial variation. If the cash book showed a million dollars was advanced to Sam Asp or the Asp account, still the important thing would be the expenses that were charged. Now, he is not challenging any of the expenses.

Mr. Monagle: Oh, I——

The Court: That is exactly what he is doing.

Mr. Monagle: I haven't got to that yet. I am trying to verify what books are missing, is all I am trying to find now, because I know they are missing, and he does. They are missing. He so testified.

Mr. Paul: All right. How are we going to

identify a bill from the Baranof Hotel or some——

Mr. Monagle: May it please the Court, they can show how much of this $5,000.00 was spent by Marvin Rubenstien for fresh fish and how much for canned. I can prove he bought fresh fish and shipped it.

Mr. Paul: What has that to do with it? Fresh fish was shipped. Is that the same five thousand or a different five thousand.

Mr. Monagle: That is what I want to find out and the books should show it.

Mr. Paul: I think this is a fishing expedition, I think counsel thinks Einstoss keeps two sets of books and that is it. [87]

Mr. Monagle: I didn't so state. He said he had books in Seattle.

Mr. Paul: We have a man here who prepares all his tax statements except the main one and——

The Court: Well, of course, but he didn't make the original entries here, and a contest of this kind depends on the production of the original entries and, if they are produced and still challenged, it depends on producing as a witness the person who made them, who can say they are correct, or at least a person who can say they are correct.

Mr. Paul: I think the Federal Business Entry Act, your Honor, will permit us to introduce records of this kind.

The Court: Yes, but, as I recall it, it requires that before they can be admitted they be produced by someone who can testify they are correct, and obviously this witness can't do that.

Mr. Paul: Mr. Einstoss testified that these were his business records.

Mr. Monagle: Mr. Einstoss testified he had his books still in Seattle.

The Court: Yes; and he further testified he knows so little about them he couldn't even say they were correct. He admitted that.

Mr. Paul: Let's go back to the original then. Mr. Einstoss identified that "these are original papers from [88] which my books were made up." If we don't take that testimony then we are put upon to identify every single invoice and receipt.

The Court: Well, as I say, you have got to connect up these individual papers with the $5,000.00 item, for instance, and I don't know how anybody can do that; that merely made a summary, assuming everything that went on before it in the way of original entries and records was correct.

Mr. Paul: Assuming the original papers are correct, why he just matches up $5,000.00 worth, and there it is.

The Court: He has to assume it. He can't testify that they are. In view of the challenge interposed here, why there ought to be somebody, it seems to me, that can show the connection between these papers here——

Mr. Paul: I am willing to——

The Court: And the disbursement of these advances.

Mr. Paul: I am willing to rest upon this, your Honor, that Mr. Einstoss when he testified personally produced the original records and that he

identified them as his records and that under the description——

The Court: Well, there is nothing affecting that identification. It isn't a matter of identifying them but, as I see it, it is a matter of connecting them up with these items. Otherwise you may have items that bear no relation whatever to these advances.

Mr. Paul: If they come out to an identical amount, what other inference can be drawn?

Mr. Monagle: I submit, they don't. Moreover Mr. Einstoss said he had everything here except the books, and this man brings this whole file with him. That proves Mr. Einstoss was lying because they are not records, and we want the rest of them. That is all.

Mr. Paul: I think counsel ought to be given time to go over these, and Mr. Ramsey will be available. We don't need to occupy the Court's time. I have gone over this situation very thoroughly and I think they all match up.

The Court: Do you want to discuss it between yourselves?

Mr. Monagle: I don't question that he thinks they are all right, but I don't.

Mr. Paul: I have already taken the time and gone over this analysis with Mr. Ramsey.

Mr. Monagle: You might be a little prejudiced in his favor though.

Whereupon, the hearing was recessed until 2:00 o'clock p.m., January 23, 1951, reconvening as per recess with respective counsel present as heretofore; and the following occurred:

Mr. Paul: I understand, your Honor, that Ramsey and Mr. Monagle conferred during the lunch hour; was it? And that [90] he indicated he had no more questions to ask Mr. Ramsey, and accordingly we agreed that he could catch the plane back to his business. Is that correct, counsel?

Mr. Monagle: Yes; I agreed that he was perfectly honest with what books he had to work with, there wasn't anything more he could testify to. He went through everything he had there. The only thing, it is impossible to find anything in that ledger showing the account was made up here. Dig around and ——

The Court: Do you mean, showing how this summary was made up?

Mr. Monagle: Yes. In other words he has made that up from papers and things he received apparently from Einstoss and of course that is all he could testify to.

The Court: You mean these papers that are here now?

Mr. Monagle: Yes. But there are very few of them original entries and no books wherein they are entered. For instance, the only account that these books show at all is, as to Sam Asp or Maude Asp or Salt Sea Fisheries, is the ledger sheet here starting October 7, 1949, and ending October 19, 1949, a period of twelve days. That is the only entry of any kind in any of these books showing any account with Sam and Maude Asp that I could find or he could find.

Mr. Paul: Well, we agreed to this effect, that

the analysis proposed to be introduced in evidence and prepared by [91] Ramsey could not be made up from any ledgers or cash books or journals but instead could only be made up from the checks and invoices and bills and things like that.

The Court: Well, it could be made up, as I see it, either way except that counsel has the right to challenge——

Mr. Paul: I mean that Ramsey did make up his analysis from the original checks and pay checks, invoices, and that he did not make it up from the ledger and journal and cash book.

Mr. Monagle: That is right. It couldn't be made up from the ledger and journal and cash book because it isn't in there.

Mr. Paul: Now, secondly, is the analysis, in so far as Ramsey is able to justify it from the original checks, invoices, vouchers, is the analysis correct?

Mr. Monagle: Well, as far as those go, it is correct, but of course he also went by a statement also apparently prepared by Mr. Einstoss which is attached for the motion for summary judgment here.

Mr. Paul: That was the Tentative Summer and Schedule A?

Mr. Monagle: I don't know what it is supposed to be. It is attached to the affidavit of Mr. Einstoss, saying among other things that on or about the 18th day of August, 1949, the affiant and defendant settled their accounts and affiant [92] paid in full the defendants for any and all services performed under said contract for 1949.

Mr. Paul: That is just a copy of Tentative Summer.

Mr. Monagle: A copy? It is a sworn affidavit. There is a notary public seal on it.

Mr. Paul: Sure. But it is the same thing as Page 3 of the Tentative Summer.

The Court: Well, what about this? Is there a way to determine from each one of those papers and documents just what it relates to, what bearing it has on the issues in this case, so that it can be incorporated in the summary? In other words, what I am getting at is this. Suppose that an accountant with a knowledge of the issues that are involved or with a knowledge of the questions started going through Einstoss' papers, would he be able to select the papers from what they show on their face that should enter into the making of a summary?

Mr. Paul: In a good many instances they are. For instance, here is a debit item, "Bank, Salt Sea Fisheries Account, August 27, 1949, received from Sam Asp in payment of exchange, drew two drafts, $50.00." This is in the possession of Einstoss, apparently was directed to him. Well, there is a credit item. Then there are numerous other——

The Court: Another question I have to ask is, wouldn't a summary of this kind to be correct have to be [93] prepared from the original entries supplemented by an examination of the papers themselves from which the original entries were made? I just don't see how anybody can walk into an office and pick out at random all the papers that have a bearing on litigation such as this, particularly one who

comes in as an independent account and not one that is connected with the place.

Mr. Paul: Well, independent but very regular, and as far as he knew he had complete access. When a man has worked even as an independent account for three years, he knows if he is getting ahold of everything.

The Court: Well, that would be true if the method of bookkeeping remained the same, but I was led to believe that after the embezzlement of this great sum that the bookkeeping changed.

Mr. Paul: There wasn't any testimony on that particular point, your Honor, but it would have elicited this testimony though, that the bookkeeping essentially did not change, that Einstoss just became a little more cautious, that is all.

The Court: Well, am I to understand now that the parties cannot agree? You do not concede, as I understand it, that this summary is correct?

Mr. Monagle: No, may it please the Court.

The Court: And you further maintain that it is not susceptible of verification? [94]

Mr. Monagle: Not from the books that are in court. That is correct, may it please the Court.

Mr. Paul: I thought counsel's position was this, that the analysis is not correct to reflect the entire position of Einstoss because there are other things not produced in court, but, in so far as the things that have been produced in court, the analysis is correct.

Mr. Monagle: Oh, I grant that quite a number of these things can be substantiated by proof, but

there is no place in these books that you can verify. In other words, if you take the books and take this summary, I don't think there is any bookkeeper in the world could say it was reflected from these books. It just can't be done.

The Court: Well, it seems to me, if those documents there are the basis of all of these debits and credits, for instance, that enter into the making up of this summary, that ought to be traceable to the books of original entry and from them a verification ought to be possible of this summary.

Mr. Monagle: Yes. If they have the books of original entry, then there is no question we could verify it.

The Court: Yes. Then with the two they would certainly be susceptible of verification.

Mr. Monagle: There wouldn't be any question about it then. I think the Court is correct. But those books aren't here. [95]

Whereupon, there was continued discussion between the Court and respective counsel.

(End of Record.) [96]

United States of America,
Territory of Alaska—ss.

I, Mildred K. Maynard, Official Court Reporter for the hereinabove-entitled court, do hereby certify:

That as such Official Court Reporter I reported the above-entitled cause, viz. James V. Cole, Plaintiff, vs. Sam Asp and Maude Asp, Copartners, doing business under their copartnership trade name

of Salt Sea Fisheries, Defendant, and S. Einstoss, Garnishee-defendant, No. 6184-A of the files of said court;

That I reported said cause in shorthand and myself transcribed said shorthand notes and reduced the same to typewriting;

That the foregoing pages numbered 1 to 96, both inclusive, contain a full, true and correct transcript of all the testimony and proceedings at the hearing of the above-entitled cause on the dates hereinbefore set out, to the best of my ability.

Witness my signature this 2nd day of May, 1951.

/s/ MILDRED K. MAYNARD,
Official Court Reporter, U. S. District Court, First Division, Territory of Alaska.

[Endorsed]: Filed May 2, 1951.

[Title of District Court and Cause.]

CLERK'S CERTIFICATE

United States of America,
Territory of Alaska,
First Division—ss.

I, J. W. Leivers, Clerk of the District Court for the Territory of Alaska, First Division thereof, do hereby certify that the hereto-attached pleadings are the original pleadings and Order filed in the above-entitled cause and are the ones designated by the

parties hereto to constitute the record on appeal herein.

In Witness Whereof, I have hereunto set my hand and caused the seal of the above-entitled court to be affixed at Juneau, Alaska, this 16th day of May, 1951.

[Seal] /s/ J. W. LEIVERS,
Clerk of District Court.

[Endorsed]: No. 12951. United States Court of Appeals for the Ninth Circuit. S. Einstoss, Appellant, vs. James V. Cole, Appellee. Transcript of Record. Appeal from the United States District Court for the Territory of Alaska, Division Number One.

Filed May 25, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

No. 12954

United States
Court of Appeals
For the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

TITLE AND TRUST COMPANY, a Corporation,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court of the United States.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12954

United States
Court of Appeals
For the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE,

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

Appearances

For Petitioner:

CLARENCE I. PHILLIPS, ESQ.

For Respondent:

JOHN H. PIGG, ESQ.

The Tax Court of the United States

Docket No. 21593

TITLE AND TRUST COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1949

Jan. 19—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 24—Copy of petition served on General Counsel.

Mar. 15—Answer filed by General Counsel.

Mar. 15—Request for hearing in Portland, Oregon, filed by General Counsel.

Mar. 16—Notice issued placing proceeding on Portland, Oregon calendar. Service of answer and request made.

Aug. 22—Hearing set Oct. 24, 1949, Portland, Oregon.

Oct. 27—Hearing had before Judge Arundell, on merits. Stipulation of facts filed at hearing. Petitioner's brief due 12/12/49. Respondent's brief due 1/10/50. Replies due 2/9/50.

Nov. 17—Transcript of hearing 10/27/49 filed.

Dec. 6—Brief filed by taxpayer. 12/7/49. Copy served.

1950

Jan. 9—Motion for extension to 2/13/50 to file brief, and to 3/15/50 to file reply brief, filed by General Counsel. Granted 1/9/50.

Feb. 8—Motion for extension to Mar. 13, 1950, to file respondent's brief and April 14, 1950, to file petitioner's reply brief filed by General Counsel. Granted 2/8/50.

Mar. 13—Motion for extension of time to March 23/50 to file brief, filed by General Counsel. 3/14/50. Granted.

Mar. 20—Reply brief filed by General Counsel.

Apr. 12—Reply brief filed by taxpayer. Copy served.

Oct. 16—Findings of fact and opinion rendered, Arundell, J. Decision will be entered under rule 50. Copy served.

Nov. 15—Respondent's computation for entry of decision filed.

Nov. 27—Hearing set Dec. 20/50, Wash., D. C., under rule 50.

Dec. 11—Consent to respondent's computation filed by taxpayer.

Dec. 13—Decision entered, Arundell, J., Div. 7.

1951

Feb. 28—Petition for review by U. S. Court of Appeals for the 9th Circuit and statement of points filed by General Counsel.

Mar. 13—Proof of service of petition filed. (Taxpayer and attorney) 2.

1951

Mar. 27—Motion for extension to May 29/51 to prepare and transmit the record filed by General Counsel.

Mar. 27—Order enlarging time to May 29/51 to prepare and transmit the record entered.

May 10—Designation of contents of record on review filed by General Counsel.

The Tax Court of the United States

T. C. Docket No. 21593

TITLE AND TRUST COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bureau Symbols IT:90D:EEH), dated November 2, 1948, and as a basis of this proceeding, hereby alleges as follows:

I.

The petitioner is a corporation organized and existing under the laws of the State of Oregon, and as a part of its business, issues and sells title insurance, and is regulated by the Insurance Com-

missioner of the State of Oregon pursuant to statutes of the State of Oregon. The principal office of the petitioner is 325 S.W. Fourth Avenue, Portland 4, Oregon. The return for the period here involved was filed with the Collector for the District of Oregon at Portland, Oregon.

II.

The Notice of Deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on November 2, 1948.

III.

The taxes in controversy are income and excess profits taxes for the taxable year ended December 31, 1945, and in the amount of $36,377.35.

IV.

The determination of tax set forth in the said Notice of Deficiency is based upon the following errors:

(a) In refusing to allow as a deduction the amount of $46,889.63 which constituted unearned premiums and which were credited to a "reserve for unearned premiums" in accordance with order of the Insurance Commissioner of the State of Oregon.

(b) In increasing the excess profits net income of the corporation in the amount of $42,546.61.

(c) In determining an excess profits tax liability for the taxable year ended December 31, 1945, in the amount of $36,377.35.

V.

Facts upon which the petitioner relies as a basis of this proceeding are as follows:

The petitioner is an insurance company as defined under the statutes of Oregon (Section 101-105 Oregon Compiled Laws Annotated) and under the statutes of Oregon (Section 101-105 Oregon Compiled Laws Annotated) the Insurance Commissioner is given the power and authority to enforce all of the laws of the State of Oregon relating to insurance, and is required to issue such department rulings, instructions and orders as he may deem necessary to secure the enforcement of the insurance laws of Oregon. An insurance company seeking to commence or continue business in the State of Oregon is required to be authorized or licensed, and if so licensed is granted a certificate of authority to transact insurance business in the State of Oregon upon its compliance with all of the laws of the State and the regulations of the Insurance Commissioner relating to such companies, and such certificate of authority may be revoked on thirty days' notice by the Insurance Commissioner or may be suspended by the Insurance Commissioner temporarily if the Insurance Commissioner deems necessary or advantageous.

Under the provisions of Section 101-136 Oregon Compiled Laws Annotated, it is required that the Insurance Commissioner shall, whenever he deems it advisable in the interest of policyholders or for the public good, examine into the affairs of any insurance company and such insurance company is required to make available to said insurance com-

missioner, or his examiner, all books, papers, records or documents of such insurance company, and the officers or agents of such insurance company may be examined under oath concerning the affairs of such company.

Under the provisions of Section 101-137 Oregon Compiled Laws Annotated, the Insurance Commissioner of the State of Oregon has the duty and authority to examine into the affairs of any insurance company and in ascertaining the condition of said insurance company, and particularly in ascertaining its liabilities, unless otherwise provided in said act, there shall be charged the capital stock, all outstanding claims, a sum equal to the total unearned premiums on the policies in force computed on a pro-rata basis, and such an amount as may be found necessary as a reserve to provide for unearned premium liability, and the amounts of such reserve are required to be formulated by such rules as the Insurance Commissioner of the State of Oregon may deem adequate and consistent with the law.

Under date of December 26, 1945, as a result of an examination made by a duly authorized examiner of the Department of Insurance for the State of Oregon, the Insurance Commissioner, by letter, addressed to this petitioner required the petitioner to establish, segregate and maintain an unearned premium or reinsurance reserve which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of the said

petitioner in statements of the petitioner; that after the expiration of 180 months from January 1, 1942, that portion of the unearned premium established more than 180 months prior thereto shall be released, and may thereafter be used for corporate purposes.

Pursuant to the order of the Insurance Commissioner of the State of Oregon, the petitioner reduced its premium earnings for the year 1945 by the sum of $46,889.63, which amount was equal to three per cent of the total gross title insurance premiums received on account of policies of insurance issued during the calendar years of 1942, 1943, 1944 and 1945.

That the petitioner was compelled to reduce its earnings in accordance with said order, and a refusal to comply with said order may have resulted in the Commissioner refusing to issue the necessary certificate for the petitioner to continue business as an insurance company in the State of Oregon.

That the reduction of the title insurance premium earnings for the year 1945 in the amount of $46,889.63 representing the amount of unearned premiums was a proper and allowable reduction from income on the federal income tax return of the petitioner in 1945, and should be allowed as a reduction.

Wherefore, the petitioner prays that this court may hear the proceeding and determine that the amount of $46,889.63 was a proper deduction by the petitioner from the income for the purpose of reporting federal income and excess profits taxes

for the year 1945, and that the above court determine that the Commissioner of Internal Revenue erred in determining a deficiency in tax in the amount of $36,377.35.

TITLE AND TRUST
COMPANY,

By /s/ E. T. DWYER,
Vice-President.

/s/ CLARENCE D. PHILLIPS,
Attorney for Petitioner.

State of Oregon,
County of Multnomah—ss.

E. T. Dwyer, being duly sworn, says that he is the Vice-President of Title and Trust Company, a corporation of Oregon, petitioner above named, and that he has read the foregoing petition and is familiar with the statements contained therein and that the statements contained therein are true except those stated to be upon information and belief, and those he believes to be true.

/s/ E. T. DWYER.

Subscribed and sworn to before me this 14th day of January, 1949.

[Seal] /s/ RUTH H. OLSON,
Notary Public for Oregon.

My Commission expires December 25, 1950.

Of Counsel:
GRIFFITH, PECK, PHILLIPS &
COUGHLIN.

EXHIBIT "A"

Treasury Department
Internal Revenue Service
Seattle 1, Washington

November 2, 1948.

Office of Internal
Revenue Agent in Charge
Seattle Division,
305 A Jones Building,
1331 Third Avenue.
IT:90D:EEH

Title and Trust Company,
325 S.W. Fourth Avenue,
Portland 4, Oregon.

Gentlemen:

You are advised that the determination of your excess profits tax liability for the taxable year ended December 31, 1945, discloses a deficiency of $36,377.35, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are

requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Seattle 1, Washington, for the attention of IT:90D:EEH. The signing and filing of this form will expediate the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

GEO. J. SCHOENEMAN,
Commissioner,

By /s/ S. R. STOCKTON,
Internal Revenue
Agent in Charge.

Enclosures:
Statement
Form of Waiver
EEH:EGG

IT:90D:EEH

STATEMENT

Title and Trust Company
325 S. W. Fourth Avenue
Portland 4, Oregon

Tax Liability for the Taxable Year Ended December 31, 1945

	Liability	Assessed	Deficiency
Excess Profits Tax	$127,475.59	$91,098.24	$36,377.35

In making this determination of your excess profits tax liability, careful consideration has been given to the report of examination dated September 5, 1947; to your protest dated March 24, 1948; and to the statements made at the conferences held on July 7, 1948, and October 6, 1948.

A copy of this letter and statement has been mailed to your representative, Mr. Clarence D. Phillips, Electric Building, Portland 5, Oregon, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income

Net income as disclosed by return, Form 1120	$203,935.77
Unallowable deductions and additional income:	
(a) Unearned premiums	46,889.63
Total	$250,825.40
Non-taxable income and additional deductions:	
(b) Amounts due the State of Oregon	4,343.02
Net income, adjusted	$246,482.38

Explanation of Adjustments

(a) In a schedule attached to your income and declared value excess profits tax return for the year 1945 you reported title insurance premiums in the total amount of $560,926.28. You reported that $46,889.63 of such total premiums constituted "unearned premiums" and credited that sum to a "reserve for unearned premiums." The sum of $46,889.63 was not included in net income reported.

The Bureau hold that title insurance premiums received in the total amount of $560,926.28 during the year 1945 were earned in that year. Net income reported has, therefore, been increased by the sum of $46,889.63.

(b) It is held that the allowable deduction for amounts due the State of Oregon in lieu of State excise tax was $24,232.60. As this deduction was claimed on your return in the amount of $19,888.58, your net income is reduced by the difference of $4,343.02 in the amounts shown.

Adjustments to Excess Profits Net Income

Excess profits net income as disclosed by return (Form 1121)	$193,422.61
Additions:	
(a) Net of the adjustments to net income	42,546.61
Excess profits net income, corrected	$235,969.22

Explanation of Adjustment

(a) Your excess profits net income is increased by the net amount of the adjustments to the net income reported on your return, Form 1120, as explained above.

Additions to net income	$46,889.63
Reductions of net income	4,343.02
Net Addition	$42,546.61

Excess Profits Tax Computation

Excess profits net income, corrected		$235,969.22
Less: Specific exemption	$10,000.00	
Excess profits credit	76,874.97	86,874.97
Adjusted excess profits net income		$149,094.25
Excess profits tax, 95% of $149,094.25		$141,639.54
Less: 10% credit, Section 784, I.R.C.		14,163.95
Correct excess profits tax liability		$127,475.59
Previous assessment—Original Account No. 4000157		91,098.24
Deficiency in excess profits tax		$ 36,377.35

Received and filed January 19, 1949.

[Title of Tax Court and Cause.]

ANSWER

Comes Now the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits, denies and alleges as follows:

1. Admits that petitioner is a corporation organized and existing under the laws of the State of Oregon; that as a part of its business, it issues and sells title insurance; that the principal office of the petitioner is 325 S. W. Fourth Avenue, Portland 4, Oregon, and that the return for the period here involved was filed with the Collector for the District of Oregon at Portland, Oregon. Denies the remaining allegations contained in paragraph I of the petition.

2. Admits the allegations contained in paragraph II of the petition.

3. Admits the allegations contained in paragraph III of the petition.

4. Denies that he erred in his determination of the deficiency as shown by the notice of deficiency from which petitioner's appeal is taken. Specifically denies that he erred in the manner and form as alleged in paragraph IV(a), (b) and (c) of the petition. Specifically denies that he determined petitioner's excess profits tax liability for the taxable year ended December 31, 1945, in the amount of $36,377.35. Alleges that he, the respondent, determined petitioner's correct excess profits tax liability for that year to be the amount of, to wit: $127,475.59, and the deficiency in excess profits tax for that year to be the amount of, to wit: $36,377.35.

5. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph V of the petition.

6. Denies generally and specifically each and every material allegation contained in the petition, not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and that the Commissioner's determination of deficiency be approved.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

WILFORD H. PAYNE,
Division Counsel;

JOHN H. PIGG,
Special Attorney,
Bureau of Internal Revenue.

Received and filed March 15, 1949.

The Tax Court of the United States

Docket No. 21593

TITLE AND TRUST COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

October 27, 1949

(Met, pursuant to notice, at 11:45 o'clock a.m.)

Before: Hon. C. Rogers Arundell, Judge.

Appearances:

C. D. PHILLIPS, ESQ.,
807 Electrical Building, Portland, Oregon,
Appearing on Behalf of the Petitioner.

J. H. PIGG, ESQ.,
(Hon. Charles Oliphant, Chief Counsel,
Bureau of Internal Revenue),
Appearing for the Respondent.

PROCEEDINGS

The Clerk: Docket 21593, Title and Trust Company.

Mr. Phillips: C. D. Phillips for the Petitioner.

Mr. Pigg: John H. Pigg for the Respondent.

The Court: I would like to have a brief statement about what this is about, Mr. Phillips.

* * * * *

Mr. Phillips: Do you want to put the return in?

The Court: Perhaps you should.

Mr. Pigg: I hadn't planned on it. It was the respondent's belief that all matters were sufficiently covered by the stipulation of fact; but just for the record I offer at this time the Respondent's Exhibit A for the information of the Court, the Petitioner's income tax return for the year 1945.

The Court: It will be received.

(Whereupon the document was marked for identification as Respondent's Exhibit A and was received.)

Mr. Pigg: Exhibit A has all of the schedules attached thereto.

The Court: Do you want to withdraw that and substitute photostatic copies?

Mr. Pigg: With permission to substitute photostatic copies.

The Court: Very well.

Is that all?

Mr. Pigg: That's all for Respondent.

The Court: We will go over until two o'clock.

(Whereupon, at 12:20 p.m. o'clock, the hearing in the above-entitled matter was concluded.)

Filed T.C.U.S. November 17, 1949.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys of record, that the following facts are true and that the same may be so considered and accepted by the Court as offered in evidence by the parties to this proceeding: Provided, however, that this stipulation shall be without prejudice to the right of either of the parties hereto to introduce other and further evidence not inconsistent with the facts herein stipulated:

1. Petitioner, an Oregon corporation, was organized on July 18, 1908, under the name of Security Title and Trust Company, for the purpose of carrying on the business of insuring titles to real estate, including the issuance of "policies of insurance and other contracts and reports affecting titles to real estate." Thereafter, and on or about August 16, 1908, petitioner's corporate name was duly changed to Title and Trust Company. At all times material to this proceeding petitioner was engaged in the business for which it was organized, and legally qualified under the statutes of the State of Oregon to engage in such business, and in connection with

its said business issued exclusively perpetual title insurance policies. Its office and principal place of business is in Portland, Oregon. It keeps its books and files the returns on the accrual basis. Its returns for the taxable year 1945 were made to the Collector for the District of Oregon.

2. The notice of deficiency, a true and correct copy of which is attached to and made a part of the petition herein, as Exhibit A thereof, was mailed by respondent to petitioner on November 2, 1948.

3. The tax in controversy in this proceeding is excess profits tax for the taxable year ended December 31, 1945, in the amount of $36,377.35.

4. Under date of December 26, 1945, the Insurance Commissioner of the State of Oregon addressed and delivered to petitioner a document in words and figures, as follows:

"State of Oregon
Department of Insurance
Fire Marshal Department

December 26, 1945.

"Title and Trust Company,
325 S. W. Fourth Avenue,
Portland 4, Oregon.

Dear Sirs:

"Pursuant to Section 101-136, O.C.L.A., an examination of your Company was made as of September 30, 1945, by a duly authorized examiner of this Department. Enclosed herewith is a copy of the examination report.

"On page 23 of said report attention is called to the advisability of making adequate reserve provision for unearned premiums. Study has been given by the Department towards the formulation of a reasonable, adequate, and sound rule for the determination of such a reserve. Consideration was given to the trend of your experience, premium volume, and size and types of risks underwritten. In order to make broader comparison with the requirements and procedures followed in other states as regards such reserves, the statutes of the various states were analyzed. As a consequence, in accordance with the provisions of Section 101-137, O.C.L.A., the following rule has been promulgated as applicable to your Company.

"1. The Title and Trust Company shall establish, segregate and maintain an unearned premium or reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of your corporation in your statements; such reserve shall be cumulative and shall be established and shall consist of the following:

"(a) As at December 31, 1945, or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calendar years—1942, 1943, 1944 and 1945; and

"(b) Monthly at the close of each month beginning January, 1946, 3% of the total gross

fees and premiums received or to be received on account of policies written during the preceding calendar month;

"(c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premium or reinsurance reserve established more than 180 months prior shall be released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purposes.

"2. As at December 31, 1945, the Title and Trust Company may charge against and reduce thereby the 'Title Loss Reserve' carried in the amount of $50,000.00 the total of losses paid during the four calendar years 1942, 1943, 1944, and 1945 on account of title policies issued; and monthly thereafter all such losses paid during the preceding calendar month may be similarly charged against this reserve. Provided, however, that the amount of said reserve shall never be less than an amount at least equal to the aggregate estimated amount due or to become due on account of all unpaid losses and claims upon title insurance policies of which the company has received notice nor less than the aggregate of title losses incurred during the preceding 36 months. After the expiration of 180 months from January 1, 1942, the balance in this reserve account, in excess of the aforementioned estimated amounts for claims due or accrued or 36 months aggregate losses, may be released and be available for any corporate use or purpose.

"3. Commencing January 1, 1946, the Title and

Trust Company shall not issue a policy of title insurance for a single transaction, the face amount of which shall exceed an amount which is five times the capital and surplus of your Company; but nothing herein shall prevent the Title and Trust Company from assuming the risk on a single policy jointly with another title insurance company or companies in excess of five times the Title and Trust Company's capital and surplus, provided that the total amount of such insurance shall not exceed five times the total combined capital and surplus of all such companies liable under such insurance; and provided that each such company shall not assume more than its proportionate share of the total amount at risk in accordance with the above-defined maximum retention limit.

"If at any date subsequent hereto, upon review or examination as provided in the Oregon Insurance Laws, it is determined that the reserves and procedures established by the rules as promulgated above are inadequate for the safety and welfare of the policyholders and not in the best interests of the company operations, said rules will be modified as necessary; furthermore, should any statute hereafter be adopted by the State of Oregon bearing on this subject, then any sections of these rules inconsistent or in conflict with said statute or statutes shall be automatically voided.

"Yours very truly,

"/s/ S. B. THOMPSON,

"SETH B. THOMPSON,

"Insurance Commissioner."

5. As at the close of the taxable year ended December 31, 1945, petitioner set upon its books an account captioned "Unearned Premiums," and at that time credited to that account the amount of $46,889.63, with a corresponding debit to "Undivided Profits." The covering journal entry was as follows:

	Debit	Credit
"Undivided Profits	$46,889.63	
Unearned Premiums		$46,889.63

To establish unearned premiums for years 1942, 1943, 1944 and 1945 in compliance with the ruling and demand of the Insurance Commissioner of the State of Oregon, dated December 26, 1945:

1942 Premium	$238,305.09	3%	$ 7,149.15
1943 Premium	330,204.13	3%	9,906.12
1944 Premium	433,552.98	3%	13,006.59
1945 Premium	560,926.28	3%	16,827.77
Total			$46,889.63"

6. In its income and declared value excess-profits tax return for the taxable year ended December 31, 1945, petitioner reported a gross income of $601,664.97, consisting of the following items:

Title insurance premiums (home and branch offices)	$560,926.28	
Less: ~~"Earned~~ Premiums"	46,889.63	$514,036.65
Abstract premiums (home and branch offices)		26,426.70
Commissions (trust, escrow and general)		29,991.76
Interest		13,132.36
Rents		17,312.50
Dividends		765.00
Total gross income reported		$601,664.97

There then followed items of deduction aggregating $407,627.36, which amount, as offset by the amounts of $375.00 and $9,523.16, representing nontaxable interest and net long-term capital gain,

respectively, none of which items are here in controversy, resulted in the net income of $203,935.77, as reported on said return.

7. The total of losses paid by petitioner during each of the calendar years 1942, 1943, 1944, and 1945 on account of title insurance policies theretofore issued by it, which amounts were charged, on its books, to the "Undivided Profits" account, and claimed as deductions on its income tax returns for those years are as follows:

Year	Amount
1942	$2,157.52
1943	1,126.97
1944	2,267.77
1945	7,394.39

Other than as above indicated by the losses so paid by petitioner during the years mentioned, there were no estimated unpaid losses and/or claims upon title insurance policies of which petitioner had notice during those years.

8. Among the items of liabilities shown on petitioner's balance sheets as at the beginning and close of the taxable year ended December 31, 1945, as shown by Schedule L of its income tax return for that year, are the following:

	Beginning	Close
"Reserve for Title Insurance Losses	$50,000.00	$50,000.00
Reserve for Unearned Premiums		46,889.63"

The above-described "Reserve for Title Insurance Losses" balance sheet item is carried on petitioner's

books in an account captioned "Reserve for Contingencies," and represents a surplus reserve, no part of which has been claimed as a deduction on any income tax return filed by petitioner. Said "Reserve for Contingencies" account was set up on petitioner's books on July 26, 1934, at which time there was credited to that account the amount of $500.00, with continuing monthly credits of like amounts until December, 1935, and thereafter like monthly credits of $1,000.00, until May 31, 1939, when the credit balance of said account reached $50,000.00, and has so remained since that date. In each instance the corresponding debit entry was to "Contingent Losses," the annually accumulated debit balances of which account were treated on the income tax returns of petitioner, for the years indicated, as charges to "Surplus." Typical of the covering monthly journal entries is the first one, relating to the July, 1934, credit, as follows:

	Debit	Credit
"Contingent Losses	$500.00	
Reserve for Contingencies		$500.00
Monthly charge for possible losses in accordance with Resolution of Board of Directors."		

9. Of the securities owned by petitioner and listed among the assets shown on its balance sheet as at December 31, 1945, as reported on its income tax return for the taxable year ended on that date, securities of a value of $100,000.00 were, on that date, on deposit with the Treasurer of the State of Oregon, as a "guarantee fund," within the meaning of Sections 101-1501 and 101-1502, O.C.L.A.

10. In his determination of the deficiency involved in this proceeding, the respondent disallowed as an exclusion and/or deduction from petitioner's gross income for the taxable year ended December 31, 1945, the aforesaid amount of $46,889.63, which action was accompanied by the following explanatory statement:

> "In a schedule attached to your income and declared value excess profits tax return for the year 1945 you reported title insurance premiums in the total amount of $560,926.28. You reported that $46,889.63 of such total premiums constituted 'unearned premiums' and credited that sum to a 'reserve for unearned premiums.' The sum of $46,889.63 was not included in net income reported.
>
> The Bureau holds that title insurance premiums received in the total amount of $560,-926.28 during the year 1945 were earned in that year. Net income reported has, therefore, been increased by the sum of $46,889.63."

11. In its consideration and decision of the issue or issues involved in this proceeding, the Court may take judicial notice of all statutory laws of the State of Oregon relating to the subject matter of said issue or issues, including Oregon Compiled Laws Annotated (O.C.L.A.), Sections 101-105(1), (2); 101-107(7); 101-136 and 101-137, relating to "Insurance Law Generally"; and Sections 101-1501, 101-1502, 101-1503, 101-1504 and 101-1505, relating

to "Title Insurance Companies," and any amendments thereto.

/s/ CLARENCE D. PHILLIPS,
Attorney for Petitioner.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent.

Filed at hearing October 27, 1949.

The Tax Court of the United States

Docket No. 21593

TITLE AND TRUST COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated October 16, 1950.

FINDINGS OF FACT AND OPINION

Complying with the directive of the Oregon Insurance Commissioner issued pursuant to Oregon statutes, petitioner segregated from its 1945 premium income an amount equal to three per cent of its total premiums received on title insurance policies issued during the calendar years 1942, 1943, 1944 and 1945. This amount was deemed by the directive to constitute unearned premiums and was set up on petitioner's books as a reserve as of

December 31, 1945. The directive further required petitioner to add to the reserve monthly thereafter an amount equal to three per cent of its premium income. At the end of 180 months from January 1, 1942, such portion of the reserve as had been maintained for more than 180 months was to be released for general corporate purposes. Held, petitioner properly excluded as "unearned premiums" from its 1945 premium income the amount of the reserve set up as of December 31, 1945. Early v. Lawyers Title Insurance Corp., 132 Fed. (2d) 42, followed.

CLARENCE D. PHILLIPS, ESQ.,
For the petitioner.

JOHN H. PIGG, ESQ.,
For the respondent.

Respondent has determined a deficiency in petitioner's excess profits tax for the calendar year 1945 in the amount of $36,377.35.

The only adjustment set forth in the deficiency notice which is disputed is respondent's determination that the entire title insurance premiums reported by the petitioner were earned and that petitioner improperly deducted therefrom "unearned premiums" in the amount of $46,889.63.

The proceeding has been submitted upon the pleadings and a stipulation of facts. The stipulated facts are summarized below in material part.

Findings of Fact

Petitioner is a corporation legally qualified by the State of Oregon to carry on the business of

insuring titles to real estate, and has its principal place of business in Portland, Oregon. During the taxable year 1945, over 75 per cent of its gross income was derived from its title insurance business in connection with which it issued exclusively perpetual title insurance policies.

Petitioner files its returns and keeps its books on the accrual basis. Its income and excess profits tax returns for the calendar years 1945 were filed with the collector of internal revenue for the district of Oregon. Respondent mailed the deficiency notice involved in this proceeding to petitioner on November 2, 1948.

On December 26, 1945, petitioner received from the Insurance Commissioner of the State of Oregon the following directive:

> Pursuant to Section 101-136, O.C.L.A.,* an examination of your Company was made as of September 30, 1945, by a duly authorized examiner of this Department. Enclosed herewith is a copy of the examination report.
>
> On page 23 of said report attention is called to the advisability of making adequate reserve provision for unearned premiums. Study has been given by the Department towards the formulation of a reasonable, adequate, and sound rule for the determination of such a reserve. Consideration was given to the trend of your experience, premium volume, and size and types of risks underwritten. In order to

*Oregon Compiled Laws Annotated. (Explanation ours.)

make broader comparison with the requirements and procedures followed in other states as regards such reserves, the statutes of the various states were analyzed. As a consequence, in accordance with the provisions of Section 101-137, O.C.L.A., the following rule has been promulgated as applicable to your Company.

1. The Title and Trust Company shall establish, segregate and maintain an unearned premium or reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of your corporation in your statements; such reserve shall be cumulative and shall be established and shall consist of the following:

(a) As at December 31, 1945, or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calendar years—1942, 1943, 1944 and 1945; and

(b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;

(c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premium or reinsurance reserve established more than 180 months prior shall be released

and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purposes.

2. As at December 31, 1945, the Title and Trust Company may charge against and reduce thereby the "Title Loss Reserve" carried in the amount of $50,000.00 the total of losses paid during the four calendar years 1942, 1943, 1944, and 1945 on account of title policies issued; and monthly thereafter all such losses paid during the preceding calendar month may be similarly charged against this reserve. Provided, however, that the amount of said reserve shall never be less than an amount at least equal to the aggregate estimated amount due or to become due on account of all unpaid losses and claims upon title insurance policies of which the company has received notice nor less than the aggregate of title losses incurred during the preceding 36 months. After the expiration of 180 months from January 1, 1942, the balance in this reserve account, in excess of the aforementioned estimated amounts for claims due or accrued or 36 months aggregate losses, may be released and be available for any corporate use or purpose.

3. Commencing January 1, 1946, the Title and Trust Company shall not issue a policy of title insurance for a single transaction, the face amount of which shall exceed an amount which is five times the capital and surplus of your Company; but nothing herein shall prevent the Title and Trust Company from assuming the risk on a single policy

jointly with another title insurance company or companies in excess of five times the Title and Trust Company's capital and surplus, provided that the total amount of such insurance shall not exceed five times the total combined capital and surplus of all such companies liable under such insurance; and provided that each such company shall not assume more than its proportionate share of the total amount at risk in accordance with the above-defined maximum retention limit.

If at any date subsequent hereto, upon review or examination as provided in the Oregon Insurance Laws, it is determined that the reserves and procedures established by the rules as promulgated above are inadequate for the safety and welfare of the policyholders and not in the best interests of the company operations, said rules will be modified as necessary; furthermore, should any statute hereafter be adopted by the State of Oregon bearing on this subject, then any sections of these rules inconsistent or in conflict with said statute or statutes shall be automatically voided.

In compliance with the above directive, petitioner set up on its books on December 31, 1945, an account captioned "Unearned Premiums" with a credit to that account in the amount of $46,889.63 and a corresponding debit to "Undivided Profits." The figure of $46,889.63 was determined in accordance with the above directive of the Insurance Commissioner as follows:

1942 Premium	$238,305.09.....3%	$ 7,149.15
1943 Premium	$330,204.13.....3%	9,906.12
1944 Premium	$433,552.98.....3%	13,006.59
1945 Premium	$560,926.28.....3%	16,827.77
Total		$46,889.63

The losses paid by petitioner during each of the calendar years 1942, 1943, 1944 and 1945 on account of title insurance policies previously issued by it were charged on its books in each of the above years to the "Undivided Profits" account and were claimed as deductions on its income tax returns for those years in the following amounts:

Year	Amount
1942	$2,157.52
1943	1,126.97
1944	2,267.77
1945	7,394.39

Other than as indicated by the losses paid by petitioner in the above years, there were no estimated unpaid losses or claims upon title insurance policies of which petitioner had notice during those years.

Among the items of liabilities shown on petitioner's balance sheets as at the beginning and close of the calendar year ended December 31, 1945, were the following:

	Beginning	Close
Reserve for Title Insurance Losses	$50,000.00	$50,000.00
Reserve for Unearned Premiums		46,889.63

The above-described "Reserve for Title Insurance Losses" balance sheet item was carried on peti-

tioner's books in an account captioned "Reserve for Contingencies" and represented a surplus reserve, no part of which has been claimed as a deduction on any income tax return filed by petitioner. This "Reserve for Contingencies" account was set up on petitioner's books on July 26, 1934, by a credit to that account in the amount of $500 with continuing monthly credits of like amounts until December, 1935, and thereafter like monthly credits of $1,000 until May 31, 1939, when the credit balance of the account equalled $50,000. In each instance the corresponding debit entry was to "Contingent Losses," the annually accumulated debit balances of this account charged to "Surplus."

Of the securities owned by petitioner and listed among the assets shown on its balance sheet as at December 31, 1945, securities of a value of $100,000 were, on that date, on deposit with the Treasurer of the State of Oregon as a "Guarantee Fund" as required by the insurance laws of the State of Oregon.

In its income and declared value excess profits tax return for the year 1945, petitioner reported a gross income of $601,664.97, consisting of the following items:

Title insurance premiums (home and branch offices)	$560,926.28	
Less: "Unearned Premiums"	46,889.63	$514,036.65
Abstract premiums (home and branch offices)		26,426.70
Commissions (trust, escrow and general)		29,991.76
Interest		13,132.36
Rents		17,312.50
Dividends		765.00
Total gross income reported		$601,664.97

This amount, as offset by items of $375 and $9,523.16, representing non-taxable interest and net long-term capital gain, respectively, neither of which items is here in controversy, resulted in net income of $203,935.77 reported in petitioner's return. In the determination of the deficiency, respondent disallowed as an exclusion or deduction from petitioner's gross income the amount of $46,889.63 reported on the return as "Unearned Premiums" with the following explanation:

> In a schedule attached to your income and declared value excess profits tax return for the year 1945 you reported title insurance premiums in the total amount of $560,926.28. You reported that $46,889.63 of such total premiums constituted "unearned premiums" and credited that sum to a "reserve for unearned premiums." The sum of $46,889.63 was not included in net income reported.
>
> The Bureau holds that title insurance premiums received in the total amount of $560,926.28 during the year 1945 were earned in that year. Net income reported has, therefore, been increased by the sum of $46,889.63.

Opinion

Arundell, Judge.

The only question here is whether petitioner properly excluded the amount designated as "unearned premiums" from its title insurance premium income. This depends upon whether the $46,889.63 so excluded constituted unearned premiums within

the meaning of section 204(b)(1)(4) and (5) of the Internal Revenue Code.[1]

In Early v. Lawyers Title Insurance Corp., 132 Fed. (2d) 42, Judge Parker, speaking for the Fourth Circuit, declared that such portions of title insurance premiums as were given for a specified period the status of unearned premiums by either law or contract should likewise be treated tax-wise as unearned premiums under section 204(b), supra. It was subsequently held by the Second Circuit that a state statute did not impart to title insurance premiums the status of being "unearned" where it was impossible to determine whether the portions

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[1]Sec. 204. Insurance Companies Other Than Life or Mutual.

* * *

(b) Definition of Income, etc.—In the case of an insurance company subject to the tax imposed by this section:

(1) Gross Income—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 22; except that in the case of a mutual fire insurance company described in paragraph (1) of subsection (a) of this section, the amount of single deposit premiums paid to such company shall not be included in gross income;

* * *

(4) Underwriting Income — "Underwriting income" means the premiums earned on insurance

of the premiums required by the statute to be set aside as a reserve would ever be released and become "free assets" of the company. City Title Insurance Co. v. Commissioner, 152 Fed. (2d) 859.

Deductibility of the statutorily prescribed reserves out of title insurance premium income thus turns on whether the local statute calls for a mere insolvency reserve of indefinite duration or whether the required reserve is established by segregating a portion of the premium income for a specified period when the risk of loss is presumably greatest. In the latter instance, the reserve becomes taxable income to the company when it is released for general corporate purposes at the expiration of the prescribed period. Commissioner v. Dallas Title & Guaranty Co., 119 Fed. (2d) 211.

Respondent does not question the authority of Early v. Lawyers Title Insurance Corp., supra (see I.T. 3798, 1946—1 C.B. 127), but argues it is not applicable because the reserve here in question was set up under a directive of the Oregon Insurance

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contracts during the taxable year less losses incurred and expenses incurred;

(5) Premiums Earned—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year. * * *

Commissioner instead of under the direct mandate of an Oregon statute.

The Insurance Code of Oregon embodied in Title 101 of Oregon Compiled Laws Annotated (O.C.L.A.) gives the Insurance Commissioner under section 101-105, O.C.L.A.,[2] authority to issue such department rulings, instructions and orders as he deems necessary to secure the enforcement of the Insurance Code. Concerning insurance reserves, section 101-137, O.C.L.A., provides as follows:

> §101-137. Examination: Reserve: Liability: (Formulating or adopting rules.) In ascertaining the condition of an insurance company under the provisions of this act, or in any examination made by the insurance commissioner, his deputy, or examiner, he shall allow as assets only such investments, cash and accounts as are authorized by the laws of this state at the date of the examination, or under the existing laws of the state or country under which such company is organized and which investment he may approve or reject, but unpaid premiums on

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[2]§101-105. General powers and duties of commissioner. (1) The insurance commissioner shall have and exercise the power to enforce all the laws of the state relating to insurance, and it shall be his duty to enforce all the provisions of such laws for the public good. He shall issue such department rulings, instructions and orders as he may deem necessary to secure the enforcement of the provisions of this act, but nothing contained in this act shall be construed to prevent any company or persons affected by any order or action of the insurance commissioner from testing the validity of same in any court of competent jurisdiction.

> policies written within three months shall be admitted as available resources. In ascertaining his [sic] liabilities, unless otherwise provided in this act, there shall be charged the capital stock, all outstanding claims, a sum equal to the total unearned premiums on the policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. In determining the amount of such reserve or unearned premium liability, the insurance commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent with law, or he may adopt such rules as are used in other states or approved by the national convention of insurance commissioners.

Acting pursuant to section 101-137, O.C.L.A., supra, the Oregon Insurance Commissioner directed the petitioner "to segregate and maintain an unearned premium or reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums * * *" The reserves were required to be three per cent of total premiums received on policies issued during 1942, 1943, 1944 and 1945 and three per cent of monthly premiums received thereafter. After 180 months, such portion of the reserve as had been established for more than 180 months would be released for general corporate purposes.

From our reading of the Oregon statutes and the directive issued to petitioner by the Oregon Insurance Commissioner, we perceive nothing to indicate that the Insurance Commissioner exceeded the bounds of his statutory authority to make rules concerning reserves. It should be apparent that a valid exercise of the discretion entrusted to the Insurance Commissioner by the Oregon statutes should have equal weight and effect as the statutes themselves. Maryland Casualty Co. v. United States, 251 U.S. 342. See also Fidelity & Deposit Co. of Maryland v. United States, ... F. Supp. ..., aff'd., 177 Fed. (2d) 805, rehearing denied, 178 Fed. (2d) 753.

Respondent urges in the alternative that so much of the $46,889.63 as is attributable to premium income received in the years 1942, 1943 and 1944 cannot properly be excluded from petitioner's premium income in the taxable year 1945. Allowance of such an exclusion, asserts respondent, would distort petitioner's 1945 income. We cannot agree. Petitioner was required by the directive of the Insurance Commissioner to set aside in the reserve a sum equal to three per cent of its premiums received on policies written during 1945 and the three preceding years. Although measured in part by premium income in the three years prior to 1945, the reserve was taken from 1945 income and thus made unavailable to the company for general corporate use the funds so restricted. The amount of the reserve was, therefore, properly excluded from "earned premiums" in 1945 when for the first time

the State of Oregon required the establishment of this reserve. A like question faced the Circuit Court in Early v. Lawyers Title Insurance Corp., supra, p. 46, where it was held that deduction of the portion of the reserve attributable to title insurance contracts issued prior to the effective date of the state statute there involved did not distort the insurance company's income in the taxable year. We are in accord with the result reached by the Circuit Court.

We conclude that respondent erred in his determination that petitioner cannot exclude from its 1945 premium income the amount required to be segregated as unearned premiums by the Oregon Insurance Commissioner pursuant to Oregon law.

Because of an uncontested adjustment,

Decision will be entered under Rule 50.

Served October 16, 1950.

The Tax Court of the United States
Washington

Docket No. 21593

TITLE AND TRUST COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

In accordance with the Opinion of the Court promulgated October 16, 1950, the respondent herein, on November 15, 1950, filed a recomputation for entry of decision, and the petitioner herein, on December 11, 1950, filed a notice of acquiescence in the respondent's recomputation. Wherefore, it is

Ordered and Decided: That there is an overpayment in excess profits tax for the calendar year 1945 in the amount of $3,713.29, all of which was paid within two years before the mailing of the notice of deficiency.

[Seal] /s/ C. R. ARUNDELL,
Judge.

Entered Dec. 13, 1950.

Served Dec. 14, 1950.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 21593

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

TITLE AND TRUST COMPANY,
Respondent on Review.

PETITION FOR REVIEW AND STATEMENT OF POINTS

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by the Tax Court of the United States on December 13, 1950, pursuant to its Findings of Fact and Opinion promulgated October 16, 1950 (15 T.C. No. 69), ordering and deciding "that there is an overpayment in excess profits tax for the calendar year 1945 in the amount of $3,713.29, all of which was paid within two years before the mailing of the notice of deficiency." This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the United States Internal Revenue Code as amended.

I.

Jurisdiction

The Title and Trust Company, respondent on

review (hereinafter sometimes referred to as "taxpayer"), is a corporation organized, under the laws of the State of Oregon, to carry on the business of insuring titles to real estate and has its principal place of business in Portland, Oregon, and filed its corporation income and declared value excess profits tax and corporation excess profits tax returns for the calendar year 1945, the taxable year involved herein, with the United States Collector of Internal Revenue for the District of Oregon, whose office is located at Portland, Oregon, which collection district is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit wherein this review is sought. This case involves Federal excess profits tax for the calendar year 1945.

II.

Nature of Controversy

The question to be presented to this Honorable Court for review is: Where taxpayer, in compliance with a directive of the Oregon Insurance Commissioner, dated December 26, 1945, segregated from its 1945 premium income an amount ($46,889.63) equal to 3 per cent of its total premiums received on title insurance policies issued during the years 1942 through 1945, and set up such amount on its books as of December 31, 1945, as an "unearned premiums" reserve—(1) did the Tax Court correctly hold that the amount of such reserve was properly excludible from taxpayer's title insurance premium gross income as "unearned premiums" within the meaning of Section 204(b)

(1)(4) and (5) of the Internal Revenue Code for Federal tax purposes; and alternatively, is that portion of the reserve ($30,061.86) attributable to premiums on policies written during the years 1942, 1943 and 1944, in any event excludible or deductible from gross income for the taxable year 1945?

The Tax Court concluded that the directive issued to the respondent on review by the Oregon Insurance Commissioner did not exceed the bounds of his statutory authority to make rules concerning reserves (Section 101-137 of Oregon Compiled Laws Annotated) and that such directive was a valid exercise of his discretion entrusted to the Insurance Commissioner by the Oregon statutes and should be accorded the weight and effect as the statutes themselves, citing and relying on Early v. Lawyers Title Insurance Corporation (CA 4, 1943), 132 F. (2) 42, and accordingly allowed the full amount of the reserve set up as of December 31, 1945, to be excluded or deducted from taxpayer's gross income for tax purposes; and it further held that since the entire amount was taken from 1945 income, and it was thus made unavailable for general corporate uses, the entire amount was therefore properly excluded from gross income by the taxpayer, although the amount of the reserve set up was measured in part by premium income in the three years prior to 1945.

The petitioner on review presents that he did not err in disallowing as an exclusion from taxpayer's gross income for the taxable year 1945 the amount of $46,889.63, representing three per cent of the

total title insurance premiums received by it on account of tile insurance contracts written during the calendar years 1942, 1943, 1944 and 1945, inasmuch as no such exclusion is either authorized or required by the laws of the taxpayer's corporate domicile; and that, in no event, no part of such reserve as is attributable to the premiums received by taxpayer during the years 1942, 1943 and 1944, on account of title insurance policies written by it during those years, amounting to $30,081.86, represents a proper exclusion or deduction from taxpayer's gross income for the taxable year 1945.

III.

Statement of Points

That the Commissioner of Internal Revenue, being aggrieved by the opinion and decision of The Tax Court of the United States in this proceeding, hereby petitions for a review of said opinion and decision by the United States Court of Appeals for the Ninth Circuit, and for the correction of the manifest errors which therein occurred and intervened to his prejudice. The Commissioner submits the following statement of points upon which he intends to rely as the basis of this petition for review:

That The Tax Court of the United States erred:

1. In holding and deciding that the taxpayer properly excluded as "unearned premiums" from its 1945 premium gross income the amount of a reserve set up as of December 31, 1945, in the

amount of $46,889.63 in compliance with a directive issued to it by the Oregon Insurance Commissioner.

2. In failing to hold and decide that the taxpayer erroneously excluded as "unearned premiums" from its 1945 premium gross income the amount of a reserve set up as of December 31, 1945, in the amount of $46,889.63 in compliance with a directive issued to it by the Oregon Insurance Commissioner.

3. In holding and concluding that the "directive" issued on December 26, 1945, "should have equal weight and effect as the statutes (of Oregon) themselves."

4. In failing to hold and conclude that no exclusion of the amount of such reserve is either authorized or required by the laws of taxpayer's corporate domicile.

5. In failing to hold and decide that the directive was of a legislative rather than an administrative character and accordingly void.

6. In holding and deciding in effect that the amount of reserve set up on December 31, 1945, in compliance with the directive of the Oregon Insurance Commissioner constitued "unearned premiums" within the meaning of Section 204(b)(1) and (5) of the Internal Revenue Code.

7. In failing to hold and decide that the amount of the reserve set up on December 31, 1945, in compliance with the directive of the Oregon Insurance Commissioner did not constitute "unearned

premiums" within the meaning of Section 204(b) (1) and (5) of the Internal Revenue Code.

8. In failing to hold and find that the so-called "reserve" taxpayer set up as of December 31, 1945, was not one in fact.

9. In failing to hold and decide that to the extent, if any, it was enforceable in Oregon, it nevertheless, did not provide a basis for an exclusion or deduction from gross income for Federal income tax purposes.

10. In failing to hold and find that the amount of $46,889.63 set up in a so-called reserve, constitutes premiums earned on insurance contracts written by taxpayer in 1945 and is taxable as such.

11. In holding and deciding that, although part of the amount the reserve was measured by premiums income in the three years prior to 1945, the entire amount thereof is properly excluded from "earned premium" income for 1945 and is accordingly not taxable in that year.

12. In failing to hold and decide, alternatively, that, in no event, the portion of the reserve ($30,081.86) attributable to the premiums received by taxpayer during the years 1942, 1943 and 1944, on account of title insurance policies written by it during those years, represents a proper exclusion or deduction from taxpayer's gross income for the year 1945.

13. In that its opinion and decision are contrary

to the laws and the regulations and are not supported by substantial evidence of record.

14. In ordering and deciding that there is an overpayment of excess profits tax for the calendar year 1945 in the amount of $3,713.29.

15. In failing to order and decide that there is a deficiency in excess profits tax for the calendar year 1945 in the amount of $36,377.35.

Wherefore, the Commissioner petitions that said findings of fact and opinion and decision of The Tax Court of the United States be reviewed by The United States Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said Court and be transmitted to the Clerk of the said Court for filing; and that appropriate action be taken to the end that the errors herein complained of may be reviewed and corrected by said Court.

/s/ THERON L. CAUDLE,
Assistant Attorney General.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Counsel for Petitioner on Review.

Of Counsel:
CLAUDE R. MARSHALL,
Special Attorney,
Bureau of Internal Revenue.

Received and filed T.C.U.S., February 28, 1951.

[Title of Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: E. T. Dwyer, Vice-President,
Title and Trust Company,
325 S.W. Fourth Avenue,
Portland, Oregon.

You are hereby notified that the Commissioner of Internal Revenue did, on the 28th day of February, 1951, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of The Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 28th day of February, 1951.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Counsel for Petitioner on Review.

Service acknowledged.

Received and filed T.C.U.S., March 13, 1951.

[Title of Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: Clarence D. Phillips, Esq.,
c/o Griffith, Peck, Phillips & Coughlin,
807 Electric Building,
Portland, Oregon.

You are hereby notified that the Commissioner of Internal Revenue did, on the 28th day of February, 1951, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of The Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 28th day of February, 1951.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Counsel for Petitioner on Review.

Service acknowledged.

Received and filed T.C.U.S., March 13, 1951.

The Tax Court of the United States

Docket No. 21593

COMMISSIONER OF INTERNAL REVENUE,

Petitioner on Review,

vs.

TITLE AND TRUST COMPANY,

Respondent on Review.

ORDER ENLARGING TIME

On motion of counsel for the petitioner on review, it is

Ordered that the time for preparation, transmission and delivery of the record sur petition for review of the above-entitled proceeding in the United States Court of Appeals for the Ninth Circuit is extended to May 29, 1951.

/s/ JOHN W. KERN,
Chief Judge.

Dated Washington, D. C., March 27, 1951.

Served March 30, 1951.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 21593

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

TITLE & TRUST COMPANY,
Respondent on Review.

DESIGNATION OF CONTENTS OF RECORD ON REVIEW

To the Clerk of The Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Court of Appeals for the Ninth Circuit pursuant to the provisions of Rule 11 of the rules of that Court as amended, the entire original record in the above-entitled proceeding in connection with the petition for review by the Court of Appeals heretofore filed by the above-named petitioner on review.

Said transcript is to be prepared as required by law and the rules of the said Court of Appeals for the Ninth Circuit.

/s/ THERON L. CAUDLE,
Assistant Attorney General.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of
Internal Revenue.

A copy of this Designation of Contents of Record on Review was duly forwarded by registered mail on this 10th day of May, 1951, to Clarence D. Phillips, Esq., c/o Griffith, Peck, Phillips & Coughlin, 807 Electric Building, Portland 5, Oregon, counsel for Respondent on Review.

/s/ C. R. MARSHALL,
Special Attorney, Bureau of Internal Revenue.

Received and filed T.C.U.S., May 10, 1951.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States do hereby certify that the foregoing documents, 1 to 27, inclusive, constitute and are all of the original papers and proceedings, including respondent's Exhibit A, on file in my office as the original and complete record in the proceeding before The Tax Court of the United States in the above-entitled proceedings and in which the petitioner of The Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United

States, at Washington, in the District of Columbia, this 22nd day of May, 1951.

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the United States.

[Endorsed]: No. 12954. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Title and Trust Company, a corporation, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed May 28, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

[Title of Court of Appeals and Cause.]

ASSIGNMENT OF ERROR TO BE URGED

The Commissioner of Internal Revenue intends to urge the following assignment of error on review of the above-entitled proceeding by the above-entitled Court:

> The Tax Court erred in allowing the Title and Trust Company, the respondent in the above-entitled proceeding, a deduction or reduction of $46,889.63, or any part thereof, from or in its gross income for the taxable year 1945, on account of so-called "unearned premiums" for the years 1942 to 1945, inclusive, and as a result thereof in expunging the deficiency determined by the Commissioner against the taxpayer in that year in the sum of $36,377.35, and each and every part thereof.

This assignment of error is intended as a composite of the statement of points to be urged set out in the petition for review of the Commissioner of Internal Revenue filed February 28, 1951.

June 4, 1951.

/s/ THERON L. CAUDLE,
Assistant Attorney General.

No. 12954

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

TITLE AND TRUST COMPANY, A CORPORATION, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

THERON LAMAR CAUDLE,
Assistant Attorney General.
ELLIS N. SLACK,
HARRY MARSELLI,
Special Assistants to the Attorney General.

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CITATIONS

In the United States Court of Appeals for the Ninth Circuit

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

TITLE AND TRUST COMPANY, A CORPORATION, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 27-41) are reported at 15 T. C. 510.

JURISDICTION

This petition for review (R. 43-49) involves a proceeding with respect to a deficiency in excess profits tax determined by the Commissioner (R. 11-14) against Title and Trust Company, a corporation (hereinafter referred to as "the taxpayer"), for the year 1945 in the amount of $36,377.35. The taxpayer is an Oregon corporation, and has its office and principal place of business in Portland, Oregon. (R. 18, 19, 28-29.) The

taxpayer filed its income and excess profits tax returns for the calendar year 1945 with the Collector of Internal Revenue for the District of Oregon. (R. 19, 29.) By letter dated November 2, 1948 (R. 11-14), the Commissioner of Internal Revenue notified the taxpayer that the determination of its excess profits tax liability for the year 1945 disclosed a deficiency in the amount above stated. Within ninety days thereafter, namely, on January 19, 1949 (R. 3), the taxpayer filed with the Tax Court a petition (R. 5-14) for a redetermination of the deficiency determined by the Commissioner as above stated, pursuant to Section 272 of the Internal Revenue Code. On December 13, 1950, the Tax Court entered its decision (R. 42), finding an overpayment in excess profits tax for the year 1945 in the amount of $3,713.29. Less than three months thereafter, namely, on February 28, 1951 (R. 4, 49), the Commissioner filed his petition (R. 43-49) for a review by this Court of the decision of the Tax Court, pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the Tax Court erred in allowing the taxpayer, a title insurance company, an exclusion from or reduction of its gross underwriting income for the taxable year 1945 under Section 204 (b) (5) of the Internal Revenue Code in the amount of $46,889.63 (or any part thereof), representing 3 per cent of the total premiums received by the taxpayer on title insurance contracts written by it during the four calendar years 1942 to 1945, inclusive.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations involved are set forth in the Appendix, *infra.*

STATEMENT

The facts in this case, which were stipulated (R. 18-27),[1] were recited by the Tax Court, in somewhat summarized fashion, in its separately stated "Findings of Fact" as follows (R. 28-35):

The taxpayer is a corporation legally qualified by the State of Oregon to carry on the business of insuring titles to real estate, and has its principal place of business in Portland, Oregon. During the taxable year 1945, over 75 per cent of its gross income was derived from its title insurance business in connection with which it issued exclusively perpetual title insurance policies. (R. 28-29.)

The taxpayer files its returns and keeps its books on the accrual basis. Its income and excess profits tax returns for the calendar year 1945 were filed with the Collector of Internal Revenue for the District of Oregon. The Commissioner mailed the deficiency notice involved in this proceeding to the taxpayer on November 2, 1948. (R. 29.)

On December 26, 1945, the taxpayer received from the Insurance Commissioner of the State of Oregon the following directive (R. 29-32):

> Pursuant to Section 101-136, O.C.L.A., an examination of your Company was made as of September 30, 1945, by a duly authorized examiner of this Department. Enclosed herewith is a copy of the examination report.
>
> On page 23 of said report attention is called to the advisability of making adequate reserve provision for unearned premiums. Study has been

[1] In addition to the stipulation of facts, there were adduced in evidence at the hearing before the Tax Court (R. 17) the taxpayer's income and declared value excess profits, and excess profits tax returns for the year 1945, as respondent's Exhibit A. That exhibit was omitted from the printed record before the Court, since it was not deemed material to the consideration of this review.

given by the Department towards the formulation of a reasonable, adequate, and sound rule for the determination of such a reserve. Consideration was given to the trend of your experience, premium volume, and size and types of risks underwritten. In order to make broader comparison with the requirements and procedures followed in other states as regards such reserves, the statutes of the various states were analyzed. As a consequence, in accordance with the provisions of Section 101-137, O.C. L.A., the following rule has been promulgated as applicable to your company.

1. The Title and Trust Company shall establish, segregate and maintain an unearned premium or reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of your corporation in your statements; such reserve shall be cumulative and shall be established and shall consist of the following:

(a) As at December 31, 1945, or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calendar years—1942, 1943, 1944 and 1945; and

(b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;

(c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premium or reinsurance reserve established more than 180 months prior shall be released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purposes.

2. As at December 31, 1945, the Title and Trust Company may charge against and reduce thereby the "Title Loss Reserve" carried in the amount of $50,000.00 the total of losses paid during the four calendar years 1942, 1943, 1944, and 1945 on account of title policies issued; and monthly thereafter all such losses paid during the preceding calendar month may be similarly charged against this reserve. Provided, however, that the amount of said reserve shall never be less than an amount at least equal to the aggregate estimated amount due or to become due on account of all unpaid losses and claims upon title insurance policies of which the company has received notice nor less than the aggregate of title losses incurred during the preceding 36 months. After the expiration of 180 months from January 1, 1942, the balance in this reserve account, in excess of the aforementioned estimated amounts for claims due or accrued or 36 months aggregate losses, may be released and be available for any corporate use or purpose.

3. Commencing January 1, 1946, the Title and Trust Company shall not issue a policy of title insurance for a single transaction, the face amount of which shall exceed an amount which is five times the capital and surplus of your Company; but nothing herein shall prevent the Title and Trust Company from assuming the risk on a single policy jointly with another title insurance company or companies in excess of five times the Title and Trust Company's capital and surplus, provided that the total amount of such insurance shall not exceed five times the total combined capital and surplus of all such companies liable under such insurance; and provided that each such company shall not assume more than its proportionate share of the total amount at risk in accordance with the above-defined maximum retention limit.

If at any date subsequent hereto, upon review or examination as provided in the Oregon Insurance Laws, it is determined that the reserves and procedures established by the rules as promulgated

above are inadequate for the safety and welfare of the policyholders and not in the best interests of the company operations, said rules will be modified as necessary; furthermore, should any statute hereafter be adopted by the State of Oregon bearing on this subject, then any sections of these rules inconsistent or in conflict with said statute or statutes shall be automatically voided.

In compliance with the above directive, the taxpayer set up on its books on December 31, 1945, an account captioned "Unearned Premiums" with a credit to that account in the amount of $46,889.63 and a corresponding debit to "Undivided Profits." (R. 32.) The figure of $46,889.63 was determined in accordance with the above directive of the Insurance Commissioner as follows (R. 33):

1942 Premium $238,305.09	3%	$ 7,149.15
1943 Premium $330,204.13	3%	9,906.12
1944 Premium $433,552.98	3%	13,006.59
1945 Premium $560,926.28	3%	16,827.77
Total		$46,889.63

The losses paid by the taxpayer during each of the calendar years 1942, 1943, 1944 and 1945 on account of title insurance policies previously issued by it were charged on its books in each of the above years to the "Undivided Profits" account and were claimed as deductions on its income tax returns for those years in the following amounts (R. 33):

Year	Amount
1942	$2,157.52
1943	1,126.97
1944	2,267.77
1945	7,394.39

Other than as indicated by the losses paid by the taxpayer in the above years, there were no estimated un-

paid losses or claims upon title insurance policies of which the taxpayer had notice during those years. (R. 33.)

Among the items of liabilities shown on the taxpayer's balance sheets as at the beginning and close of the calendar year ended December 31, 1945, were the following (R. 33):

	Beginning	Close
Reserve for Title Insurance Losses	$50,000.00	$50,000.00
Reserve for Unearned Premiums		46,889.63

The above-described "Reserve for Title Insurance Losses" balance sheet item was carried on the taxpayer's books in an account captioned "Reserve for Contingencies" and represented a surplus reserve, no part of which has been claimed as a deduction on any income tax return filed by the taxpayer. This "Reserve for Contingencies" account was set up on the taxpayer's books on July 26, 1934, by a credit to that account in the amount of $500 with continuing monthly credits of like amounts until December, 1935, and thereafter like monthly credits of $1,000 until May 31, 1939, when the credit balance of the account equalled $50,000. In each instance the corresponding debit entry was to "Contingent Losses," the annually accumulated debit balances of this account being charged to "Surplus." (R. 33-34.)

Of the securities owned by the taxpayer and listed among the assets shown on its balance sheet as at December 31, 1945, securities of a value of $100,000 were, on that date, on deposit with the Treasurer of the State of Oregon as a "Guarantee Fund" as required by the insurance laws of the State of Oregon. (R. 34.)

In its income and declared value excess profits tax return for the year 1945, the taxpayer reported a gross

income of $601,664.97, consisting of the following items (R. 34):

Title Insurance premiums (home and branch offices)	$560,926.28	
Less: "Unearned Premiums"	46,889.63	$514,036.65
Abstract premiums (home and branch offices)		26,426.70
Commissions (trust, escrow and general)		29,991.76
Interest		13,132.36
Rents		17,312.50
Dividends		765.00
Total gross income reported		$601,664.97

This amount, as offset by items of $375 and $9,523.16, representing non-taxable interest and net long-term capital gain, respectively, neither of which items is here in controversy, resulted in net income of $203,935.77 reported in the taxpayer's return. In the determination of the deficiency, the Commissioner disallowed as an exclusion or deduction from the taxpayer's gross income the amount of $46,889.63 reported on the return as "Unearned Premiums" with the following explanation (R. 35):

> In a schedule attached to your income and declared value excess profits tax return for the year 1945 you reported title insurance premiums in the total amount of $560,926.28. You reported that $46,889.63 of such total premiums constituted "unearned premiums" and credited that sum to a "reserve for unearned premiums." The sum of $46,889.63 was not included in the net income reported.
>
> The Bureau holds that title insurance premiums received in the total amount of $560,926.28 during

the year 1945 were earned in that year. Net income reported has, therefore, been increased by the sum of $46,889.63.

The Tax Court held (R. 35-41) that the Commissioner had erred in his determination that the taxpayer could not exclude from its 1945 gross income the $46,889.63 in question as "Unearned Premiums," and accordingly entered its decision finding an overpayment in excess profits tax for 1945 in the amount of $3,713.29 (R. 42). The present review followed.

STATEMENT OF POINTS TO BE URGED

The points urged and relied upon by the Commissioner on the present review were originally stated at length by him in his petition for review (R. 46-49), and were later restated by him in this Court (R. 56) in a composite or summarized fashion substantially as follows:

The Tax Court erred in allowing the taxpayer a deduction from or reduction of its gross income for the taxable year 1945 in the amount of $46,889.63, or any part thereof, on account of so-called "unearned premiums" for the years 1942 to 1945, inclusive, and as a result thereof in expunging the deficiency determined by the Commissioner against the taxpayer for the year 1945 in the amount of $36,377.35.

SUMMARY OF ARGUMENT

This review involves a question substantially identical to that presented in *United States* v. *Pacific Abstract Title Co.,* now pending before this Court as Cause No. 12,894. For the reasons pointed out in our brief in the *Pacific Abstract* case, and the additional comments made hereinafter, it is submitted that the holding of the Tax Court in this case is erroneous and should be reversed.

ARGUMENT

The Taxpayer Was Not Entitled to a Deduction under Section 204 (b)(5) of the Internal Revenue Code for the Reserve Required to Be Maintained by the Directive of the Insurance Commissioner of Oregon Purportedly as a Reserve for "Unearned Premiums"

With certain minor differences in factual details, which will be hereinafter referred to, this case is identical to the case of *United States* v. *Pacific Abstract Title Co.,* Cause No. 12,894, before this Court on appeal from the United States District Court for the District of Oregon. Therefore, in order to avoid burdening this Court with unnecessary repetition, we adopt in this case and incorporate herein by reference the argument advanced in the brief heretofore filed in this Court in the *Pacific Abstract Title Co.* case on behalf of the appellant, the United States, and respectfully request that it be considered in this case.

In our brief before this Court in the *Pacific Abstract* case, in support of our position that the taxpayer there was not entitled to the deduction of the reserve in question, as a purported reserve for "unearned premiums," in the determination of taxable income, we advanced the following contentions, briefly stated: (1) Because of the inherent nature of title insurance, premiums are fully earned when the policies are written and no portion thereof may be treated as "unearned premiums" and as such be excluded or deducted from gross income for tax purposes; (2) the Insurance Commissioner of the State of Oregon exceeded his authority when he purported by his directive to convert (retroactively) any portion of the premiums previously fully earned by the taxpayer into "unearned premiums"; (3) even if the reserve which the Insurance Commissioner required the taxpayer to establish purportedly as an "unearned premium" reserve might possibly be viewed as a valid

reserve of another character under the Oregon statute, it would still not be deductible for tax purposes, because insurance companies of the class taxable under Section 204 of the Internal Revenue Code (Appendix, *infra*) are not entitled to the deduction of any reserves in the computation of taxable income; and, finally, and in the alternative, (4) even if it were held that the Insurance Commissioner could convert some part of title insurance premiums into "unearned premiums, his action could not be given effect *retroactively*" for tax purposes, so as to convert retroactively a portion of the premiums previously written and fully earned by the taxpayer into "unearned premiums." We adopt those contentions in this case, and upon the basis thereof respectfully submit that the decision of the Tax Court in this case, allowing this taxpayer to deduct the disputed reserve as a purported reserve for "unearned premiums," should be reversed.

The factual differences between this case and the *Pacific Abstract* case, though in minor detail, all—with one exception, which, as hereinafter brought out, relates only to the alternative contention (stated under "(4)" in the preceding paragraph) against retroactive application of the directive—serve to demonstrate even more effectively the correctness of the Government's position that the disputed reserve involved in the two cases is not deductible in the determination of taxable income.

The first factual difference to which we may call attention is the fact that the taxpayer in this case had, before the taxable year here involved (1945), voluntarily set up and accumulated a reserve in the amount of $50,000 described as a "Reserve for Title Insurance Losses," by periodic credits to an account on its books captioned "Reserve for Contingencies" between

July 26, 1934, and May 31, 1939.[2] (R. 24-25, 33-34.) The amounts credited to that reserve by the taxpayer had been charged to "Surplus," and no part thereof had ever been claimed as a deduction for tax purposes by the taxpayer. (R. 25, 34.) By the same directive which required the establishment of the purported "unearned premium" reserve in question, the Insurance Commissioner authorized the taxpayer in this case to take out of and reduce this $50,000 "Title Loss Reserve," as of December 31, 1945, by the total of losses paid on account of title policies during the four years 1942 to 1945, inclusive, and thereafter to charge against that reserve each month all losses paid during the preceding month. (R. 21.) The authorized taking down or reduction of that loss reserve was limited by a proviso to the effect that the amount in the reserve should never be less than an amount equal to the aggregate estimated amount of all unpaid losses and claims of which the taxpayer has received notice, nor less than the aggregate of title losses incurred during the preceding 36 months. (R. 21.) The directive further provided that after the expiration of 180 months from January 1, 1942,[3] the balance remaining in this loss reserve in excess of the above-mentioned alternative minimums would be released and be available for any corporate use or purpose. (R. 21.)

This authorized release of the previously established voluntary loss reserve serves to demonstrate more convincingly than ever, we believe, that the purported "unearned premium" reserve was in reality a reserve against contingent losses which might arise in the

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[2] No reserve of this character had been previously set up by the taxpayer in the *Pacific Abstract* case, at least insofar as disclosed by the record in that case.

[3] Similarly, at the same time, 180 months after January 1, 1942, the purported "unearned premium" reserve was to begin to be released. (R. 21.)

future—i.e., losses then unknown, of which the taxpayer as yet had received no notice, but which were expected to arise in the future. In net result, what the Insurance Commissioner of Oregon required the taxpayer to do by the directive in question was to maintain (1) a reserve to cover the estimated amount of *known* losses unpaid and outstanding (which he required be maintained as a minimum in the previously established loss reserve above mentioned) and (2) a reserve to cover *unknown* or contingent losses expected to arise in the future (which he required be set up as a purported "unearned premium" reserve).[4]

It is, of course, a well settled general principle of tax law that reserves set up for future or contingent losses cannot be deducted for tax purposes. See *Lucas* v. *American Code Co.,* 280 U.S. 445; *Brown* v. *Helvering,* 291 U.S. 193; *Security Mills Co.* v. *Commissioner,* 321 U.S. 281; *Spencer, White & Prentis* v. *Commissioner,* 144 F. 2d 45 (C.A. 2d), certiorari denied, 323 U.S. 780; *Capital Warehouse Co.* v. *Commissioner,* 171 F. 2d 395 (C.A. 8th). As brought out in our *Pacific Abstract* brief in this Court (pp. 26-28), insurance companies other than life or mutual, taxable under Section 204 of the Code, are not entitled to the deduction of any reserves in the computation of taxable income. And, we may add, the mere fact that a reserve is required by state law is not of itself sufficient to entitle a taxpayer to a deduction therefor. See *American Title Co.* v. *Commissioner,* 29 B.T.A. 479, 482, affirmed, 76 F. 2d 332, 333 (C.A. 3d), and *Pacific*

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[4] The same is the net result, in effect, of the directive issued to the taxpayer in the *Pacific Abstract* case, which directive required that taxpayer to set up and maintain thereafter a "Title Loss Reserve" at least equal to the aggregate estimated amount of *known* losses unpaid, but not less than the aggregate of title losses incurred during the preceding 36 months. (*Pacific Abstract,* R. 39.)

Employers Insurance Co. v. *Commissioner,* 33 B.T.A. 501, 503, affirmed, 89 F. 2d 186 (C.A. 9th).[5]

Another difference between the instant case and the *Pacific Abstract* case is that the record in this case shows affirmatively that this taxpayer took deductions on its income tax returns for the amount of the losses paid on account of title policies during the taxable year 1945, as well as during the years 1942, 1943 and 1944. (R. 24, 33.) Since a deduction has already been taken for losses paid, to allow the taxpayer to also deduct this purported "unearned premium" reserve, which is really a reserve for contingent losses, would be to allow a double deduction, which would be contrary to settled principles of income tax law.

Another difference between the two cases is that the record in the instant case shows that the amount of the disputed reserve purportedly for "unearned premiums" has actually been charged by the taxpayer on its books against its "Undivided Profits" account.[6] (R. 23.) In our view that is the correct treatment of the reserve: As pointed out in our *Pacific Abstract* brief (p. 31), the amount of this purported "unearned premium" reserve should be established out of the earned surplus of the company. It is unquestionable that it is not a proper charge against the 1945 income of the taxpayer and should not be allowed as a deduction for tax purposes from the taxpayer's 1945 income.

The last difference between the instant case and the *Pacific Abstract* case is that the directive of the In-

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[5] This Court recently adhered to its *Pacific Employers* decision in *Pacific Ins. Co.* v. *United States*, 188 F. 2d 571, now pending before the Supreme Court on a petition for certiorari (No. 77, October Term, 1951), in response to which the Government has filed a memorandum not opposing the granting of the writ.

[6] It may be pointed out that in this respect the Tax Court was in error when it stated, in the course of its opinion in the instant case, that the amount of the reserve "was taken from 1945 income." (R. 40.)

surance Commissioner, requiring the establishment of the purported "unearned premium" reserve, was issued and delivered to this taxpayer on December 26, 1945.[7] (R. 19, 29.) This is the one factual difference between the two cases which relates only, as we have indicated, to the alternative contention against the retroactive application of the directive, to which we have referred as the fourth contention advanced in our *Pacific Abstract* brief. Because the directive to the taxpayer in this case was issued on December 26, 1945, our alternative argument against retroactive application in this case is slightly modified. In this case our alternative position is that, even if it were held that the Insurance Commissioner could convert some part of title premiums into "unearned premiums," his action could not be given effect retroactively for tax purposes with respect to premiums written and fully earned by this taxpayer before the date of the directive, December 26, 1945. In other words, the directive, if valid, could be effective to convert into "unearned premiums" three per cent of the premiums written after the directive was issued on December 26, 1945, and up to the end of the taxable year, December 31, 1945. Therefore, if the directive were valid, the most that the taxpayer would have been entitled to exclude from gross income would have been three per cent of the premiums written between December 26 and December 31, 1945. Since the taxpayer has failed to establish the amount of the premiums written between December 26 and December 31, 1945, however, it would not in any event be entitled to any deduction or exclusion from gross income on account thereof because of its failure of proof in that respect.

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[7] The directive to the taxpayer in the *Pacific Abstract* case was issued on January 12, 1946. (*Pacific Abstract,* R. 26, 37.)

CONCLUSION

It is submitted that the decision of the Tax Court in this case is erroneous and should be reversed, and that the determination of the Commissioner of Internal Revenue should be reinstated.

Respectfully submitted,

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
HARRY MARSELLI,
Special Assistants to the Attorney General.

SEPTEMBER, 1951.

APPENDIX

Internal Revenue Code:

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(a) [As amended by Section 164(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and by Section 135(a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Imposition of Tax.*—

(1) *In General.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income and upon the corporation surtax net income of every insurance company (other than a life or mutual insurance company) and every mutual marine insurance company and every mutual fire insurance company exclusively issuing either perpetual policies, or policies for which the sole premium charged is a single deposit which (except for such deduction of underwriting costs as may be provided) is refundable upon cancellation or expiration of the policy taxes at the rates specified in section 13 or section 14(b) and in section 15(b).

* * * * *

(b) *Definition of Income, Etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) [As amended by Section 135(b) of the Revenue Act of 1943, *supra*]. *Gross Income.*—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 22; except that in the case of a mutual fire insurance company described in

paragraph (1) of subsection (a) of this section, the amount of single deposit premiums paid to such company shall not be included in gross income;

(2) *Net Income.*—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

(3) *Investment Income.*— * * *

(4) *Underwriting Income.*—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) [As amended by Section 164(b) of the Revenue Act of 1942, *supra*]. *Premiums Earned.*—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year. For the purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in section 201 (c)(2), pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by this section and not qualifying as a life insurance company under section 201 (b);

(6) *Losses Incurred.*— * * *

(7) *Expenses Incurred.*— * * *

(c) [As amended by Section 226 of the Revenue Act of 1939, c. 247, 53 Stat. 862, Sections 124 and 164 of the Revenue Act of 1942, *supra*, and Section 135 of the Revenue Act of 1943, *supra*]. *Deductions Allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23 (a);

(2) All interest as provided in section 23 (b);

(3) Taxes as provided in section 23 (c);

(4) Losses incurred as defined in subsection (b)(6) of this section;

(5) *Capital losses.*—Capital losses to the extent provided in section 117 plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. * * *

* * * * *

(6) Debts in the nature of agency balances and bills receivable which become worthless within the taxable year;

(7) The amount of interest earned during the taxable year which under section 22 (b)(4) is excluded from gross income;

(8) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (l);

(9) Charitable, and so forth, contributions, as provided in section 23 (q);

(10) Deductions (other than those specified in this subsection) as provided in section 23;

(11) Dividends and similar distributions paid or declared to policyholders in their capacity as such, except in the case of a mutual fire insurance company described in paragraph (1) of subsection (a) of this section. The term "paid or declared" shall be construed according to the method of accounting regularly employed in keeping the books of the insurance company.

* * * * *

(e) *Double Deductions.*—Nothing in this section shall be construed to permit the same item to be twice deducted.

* * * * *

(26 U.S.C. 1946 ed., Sec. 204.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> Sec. 29.204-1 [As amended by T.D. 5369, 1944 Cum. Bull. 333, 334]. *Tax on Insurance Companies Other Than Life or Mutual and Mutual Marine Insurance Companies and Mutual Fire Insurance Companies Issuing Perpetual Policies.*—All insurance companies, other than life or mutual or foreign insurance companies not carrying on an insurance business within the United States, and all mutual marine insurance companies and mutual fire insurance companies exclusively issuing either perpetual policies, or policies for which the sole premium charged is a single deposit which, except for such deduction of underwriting costs as may be provided, is refundable upon cancellation or expiration of the policy, are subject to the tax imposed by section 204. * * * The net income of insurance companies is defined in section 204 and differs from the net income of other corporations. * * * Since section 204 provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the returns under section 204 shall be made on the basis of the calendar year and shall be on Form 1120. * * *
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> * * * * *
>
> Sec. 29.204-2 [As amended by T.D. 5369, *supra*]. *Gross Income.*—Gross income as defined in section 204 (b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from the sale or other disposition of property, and all other items constituting gross income under section 22, except

that in the case of a mutual fire insurance company described in section 29.204-1 the amount of single deposit premiums received, but not assessments, shall be excluded from gross income. * * * The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Internal Revenue Code will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Code. * * * In computing "premiums earned on insurance contracts during the taxable year" the amount of the unearned premiums shall include (1) life insurance reserves as defined in section 201 (c)(2) and section 29.201-4 pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by section 204 and not qualifying as a life insurance company under section 201 (b), and (2) liability for return premiums under a rate credit or retrospective rating plan based on experience, such as the "War Department Insurance Rating Plan," and which return premiums are therefore not earned premiums. * * *

Sec. 29.204-3 [As amended by T.D. 5369, *supra*]. *Deductions.*—The deductions allowable are specified in section 204 (c) and by reason of the provisions of section 204 (c)(10) include deductions (other than those specified in section 204 (c) as provided in section 23. * * *

* * * * *

7 Oregon Compiled Laws Annotated (1940):

Sec. 101-105.—*General powers and duties of commissioner.* (1) The insurance commissioner shall have and exercise the power to enforce all the laws of the state relating to insurance, and it shall be his duty to enforce all the provisions of such laws for the public good. He shall issue such department rulings, instructions and orders as he may deem necessary to secure the enforcement of

the provisions of this act, but nothing contained in this act shall be construed to prevent any company or persons affected by any order or action of the insurance commissioner from testing the validity of same in any court of competent jurisdiction.

* * * * *

(3) [Furnishing of form for financial statement.] Every insurance company, doing business in the state, shall file with the commissioner, on or before March 1st of each year, a financial statement for the year ending December 31st immediately preceding on [a] form furnished by the commissioner, which shall conform as nearly as may be to the form of statement from time to time adopted by the national convention of insurance commissioners, and containing such detailed exhibit of the condition and transactions of the company as the commissioner, in such form and otherwise shall reasonably prescribe. Such statement shall be verified by the oaths of the president and secretary of the company, or in their absence by two other principal officers. The statement of a company of a foreign country shall embrace only its condition and transactions in the United States, and shall be verified by the oath of its resident manager or principal representative in the United States. In the discretion of the commissioner, a penalty of ten dollars per day shall attach for delinquency in filing such statement.

* * * * *

SEC. 101-136. (*Examination into affairs of company or persons in insurance business: Appointment of examiners: Duty to produce books and papers and to facilitate examination: Report of examiners: Hearing: Inspection and publication of report: Expenses of examination.*) The insurance commissioner shall, whenever he deems it advisable in the interest of policyholders or for the public good, examine into the affairs of any insurance company, agency, corpora-

tion, partnership, person or persons engaged in or proposing to engage in the insurance business of this state, and into the affairs of any company organized under any law of this state or having an office or representative in this state, which company is engaged in or is claiming or advertising that it is engaged in organizing or receiving subscriptions for or disposing of stock of, or in any manner aiding or taking part in the formation or business of an insurance company or companies, or which is holding capital stock of one or more insurance companies for the purpose of controlling the management thereof as voting trustee or otherwise. * * * It shall be the duty of the insurance commissioner to examine every domestic insurance company at least once in three years.

Sec. 101-137. *Examination: Reserve: Liability: (Formulating or adopting rules).* In ascertaining the condition of an insurance company under the provisions of this act, or in any examination made by the insurance commissioner, his deputy, or examiner, he shall allow as assets only such investments, cash and accounts as are authorized by the laws of this state at the date of the examination, or under the existing laws of the state or country under which such company is organized and which investment he may approve or reject, but unpaid premiums on policies written within three months shall be admitted as available resources. In ascertaining his liabilities, unless otherwise provided in this act, there shall be charged the capital stock, all outstanding claims, a sum equal to the total unearned premiums on the policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. In determining the amount of such reserve or unearned premium liability, the insurance commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent with law or he may adopt such rules as are used in other

states or approved by the national convention of insurance commissioners.

SEC. 101-138. *Revocation of certificate or license: Court review.* (1) If the commissioner shall find upon examination or other evidence that any insurance company is in an unsound condition, or that it has failed to comply with the law or with the provisions of its charter or articles of incorporation or association, or that its condition is such as to render its proceedings hazardous to the public or to its policy-holders, or that its actual assets exclusive of its capital are less than its liabilities, or if its trustees, directors, officers, or agents refuse to submit to examination or to produce at the office where the same are kept, its books, records, accounts, and papers in its or their possession or control relating to its business or affairs, for examination and inspection of the commissioner, his deputy or examiner, when required, or shall refuse to perform any legal obligation relative to such examination, the commissioner shall revoke or suspend all certificates of authority and licenses granted to such insurance company, its officers or agents, and shall cause notice thereof to be given to such company and to each agent of such company in this state and no new business shall thereafter be done by such company or for such company by its agents, in this state, while such revocation, suspension, or disability continues, nor until its authority to do business is restored by the commissioner.

* * * * *

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No. 12954

In the United States Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

TITLE AND TRUST COMPANY,
A CORPORATION,
Respondent.

On Petition for Review of the Decision of the Tax Court of the United States

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Portland 5, Oregon

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BRIEF FOR RESPONDENT

JURISDICTION

Jurisdiction of the above court is asserted by the Commissioner of Internal Revenue by reason of the provisions of *Section 1141 (a) of the Internal Revenue Code as amended by Section 36 of the Act of June 25, 1948.* The petition for review is from an order of the

Tax Court of the United States of which the Findings of Fact and Opinion are reported in *15 TC 510.* The jurisdictional facts are set forth in Petitioner's Brief.

QUESTIONS PRESENTED

(a) Whether or not the amount of $46,889.63 deducted as "unearned premiums" pursuant to an order of the Insurance Commissioner of Oregon made in accordance with the statutes of Oregon is a proper deduction from gross premium income and properly excluded from earned income under *Section 204 (b) (1), (4), (5) of the Internal Revenue Code.*

(b) Respondent also raises the question as to whether or not the total amount of $46,889.63 may be deducted in 1945 rather than deducted from the corporate income of 1942, 1943 and 1944 even though the order of the Insurance Commissioner of the State of Oregon was not issued until December, 1945.

STATUTES INVOLVED

Pertinent provisions of the Internal Revenue Code are set forth in this brief, and pertinent statutes of Oregon, are set forth in the Appendix, *infra.*

STATEMENT OF CASE

The facts in the case were submitted by written stipulation of facts in the Tax Court of the United States (R. 18-27). The only exhibits introduced in the case were the Respondent's income and declared value ex-

cess profits, and excess profits tax returns for the year 1945, introduced as Exhibit A. The findings made by the Tax Court are set forth in the record (R. 28-35).

Title and Trust Company is a corporation organized and existing under and by virtue of the laws of the State of Oregon, and a principal part of its business is the issuing of title insurance policies on property in the State of Oregon. The policies are single premium policies and issued in perpetuity although the liability on such policies diminishes and is ultimately extinguished with the passage of time by reason of the fact that any defects which might arise therein would ultimately be eliminated by the statute of limitations, laches and estoppel and other features of common and statutory law.

Title and Trust Company duly filed its report of income and excess profits taxes with the Collector of Internal Revenue at Portland, Oregon for the calendar year 1945, the income being determined and reported on the accrual basis of accounting. The Commissioner on examination of the return disallowed a deduction from income in the amount of $46,889.63 which had been accrued and credited in 1945 by the Title and Trust Company to a "reserve for unearned premiums" pursuant to an order of the Insurance Commissioner of the State of Oregon. The Commissioner of Internal Revenue asserted a deficiency of excess profits tax liability in the amount of $36,377.35.

Under date of December 26, 1945, the Insurance Commissioner of the State of Oregon addressed and delivered to Title and Trust Company his order in words and figures as follows, to-wit: (R. 19-22)

"STATE OF OREGON
Department of Insurance
Fire Marshall Department
December 26, 1945

"TITLE AND TRUST COMPANY
325 S. W. Fourth Avenue
Portland 4, Oregon

Dear Sirs:

"Pursuant to Section 101-136, O.C.L.A., an examination of your Company was made as of September 30, 1945 by a duly authorized examiner of this Department. Enclosed herewith is a copy of the examination report.

"On page 23 of said report attention is called to the advisability of making adequate reserve provision for unearned premiums. Study has been given by the Department towards the formulation of a reasonable, adequate, and sound rule for the determination of such a reserve. Consideration was given to the trend of your experience, premium volume, and size and types of risks underwritten. In order to make broader comparison with the requirements and procedures followed in other states as regards such reserves, the statutes of the various states were analyzed. As a consequence, in accordance with the provisions of Section 101 - 137, O.C.L.A. the following rule has been promulgated as applicable to your Company.

"1. The Title and Trust Company shall establish, segregate and maintain an unearned premium or reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of your corporation in your statements; such reserve shall be cumulative and shall be established and shall consist of the following:

"(a) As at December 31, 1945 or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the calendar years - 1942, 1943, 1944 and 1945; and "(b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;

"(c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premium or re-insurance reserve established more than 180 months prior shall be released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purposes.

"2. As at December 31, 1945, the Title and Trust Company may charge against and reduce thereby the 'Title Loss Reserve' carried in the amount of $50,000.00 the total of losses paid during the four calendar years 1942, 1943, 1944, and 1945 on account of title policies issued; and monthly thereafter all such losses paid during the preceding calendar month may be similarly charged against this reserve. Provided, however, that the amount of said reserve shall never be less than an amount at least equal to the aggregate estimated amount due or to become due on account of all unpaid losses and claims upon title insurance policies of which the company has received notice nor less than the aggregate of title losses incurred during the preceding 36 months. After the expiration of 180 months from January 1, 1942, the balance in this reserve account, in excess of the aforementioned estimated amounts for claims due or accrued or 36 months aggregate losses, may be released and be available for any corporate use or purpose.

"3. Commencing January 1, 1946 the Title and Trust Company shall not issue a policy of title insurance for a single transaction, the face amount of which shall exceed an amount which is five times the capital and surplus of your Company; but nothing herein shall

prevent the Title and Trust Company from assuming the risk on a single policy jointly with another title insurance company or companies in excess of five times the Title and Trust Company's capital and surplus, provided that the total amount of such insurance shall not exceed five times the total combined capital and surplus of all such companies liable under such insurance; and provided that each such company shall not assume more than its proportionate share of the total amount at risk in accordance with the above defined maximum retention limit.

"If at any date subsequent hereto, upon review or examination as provided in the Oregon Insurance Laws, it is determined that the reserves and procedures established by the rules as promulgated above are inadequate for the safety and welfare of the policyholders and not in the best interests of the company operations, said rules will be modified as necessary; furthermore should any statute hereafter be adopted by the State of Oregon bearing on this subject, then any sections of these rules inconsistent are in conflict with said statute or statutes shall be automatically voided.

Yours very truly,
/s/ SETH B. THOMPSON
Seth B. Thompson
Insurance Commissioner"

As of the close of the taxable year ending December 31, 1945 Title and Trust Company set up on its books an account captioned "Unearned Premiums", and at that time credited to that account $46,889.63, with a corresponding debit to "Undivided Profits", the journal entry thereon being as follows:

	DEBIT	CREDIT
"Undivided Profits	$46,889.63	
Unearned Premiums		$46,889.63
To establish unearned premiums for years 1942, 1943, 1944 and 1945 in		

compliance with the ruling and demand of the Insurance Commissioner of the State Oregon, dated December 26, 1945:

1942	Premium	238,305.09	3%	7,149.15
1943	"	330,204.13	3%	9,906.12
1944	"	433,552.98	3%	13,006.59
1945	"	560,926.28	3%	16,827.77
Total				46,889.63"

In its income and declared value excess profits tax return for the taxable year ended December 31, 1945, Title and Trust Company reported a gross income of $601,664.97 consisting of the following items:

Title insurance premiums (home and branch offices)	$460,926.28	
Less: "Unearned Premiums"	46,889.63	$514,036.65
Abstract premiums (home and branch offices)		26,426.70
Commissions (trust, escrow and general)		29,991.76
Interest		13,132.36
Rents		17,312.50
Dividends		765.00
Total gross income reported		$601,664.97

From the gross income there was deducted $407,627.-31 which amount was offset by the amount of $375 and $9,523.16 representing non-taxable interest and net long-term capital gain, respectively, none of which items are in controversy, resulting in a net income to the Title and Trust Company amounting to $203,935.77 as reported on said return.

The Stipulation of Facts (R. 19-22) also refers to a

reserve for title insurance losses in the amount of $50,000 and also a deposit with the Insurance Commissioner in the amount of $100,000. The first reserve is a voluntary reserve created and accumulated by the Board of Directors of Title and Trust Company out of its earned surplus and upon which income tax had theretofore been paid. The second is a statutory deposit required by the statutes of Oregon in order to qualify for the writing of title insurance in Oregon. The references to these reserves were incorporated in the Stipulation of Facts at the request of the Commissioner and Title and Trust Company has no objection to such recitations being therein although it is the position of the Respondent here that neither the voluntary reserve nor the statutory deposit has any bearing upon the issues in the case.

Under the Stipulation of Facts the Tax Court was permitted to take judicial notice of all the statutory laws of the State of Oregon, including those specifically referred to in the Stipulation of Facts. Wherever the designation of O.C.L.A. is herein used, it refers to Oregon Compiled Laws Annotated, the official statutes of Oregon.

The Tax Court (R. 35-41) held that the Commissioner had erred in his determination that the taxpayer could not exclude from its 1945 gross income the sum of $46,889.63 as "unearned premiums" and allowed

such deduction and accordingly entered its decision finding an overpayment in excess profits tax for the calendar year 1945 in the amount of $3,713.29 (R. 42).

STATEMENT OF POINTS TO BE URGED

(a) That gross income of an insurance company (other than a life or mutual company) under *Section 204 (b) (1) of the Internal Revenue Code* includes only the amount "earned" during the taxable year from underwriting income.

(b) Underwriting income under *Section 204 (b) (4)* means premiums *earned* on insurance contracts during the taxable year, less losses incurred and expenses incurred.

(c) Premiums earned are defined in *Section 204 (b) (5) of the Internal Revenue Code,* which provides for the adjustment for unearned premiums.

(d) That the deduction for unearned premiums taken by Title and Trust Company in 1945 in the amount of $46,889.63 was justified under the provisions of *Section 204 of the Internal Revenue Code.*

(e) That the statutes of Oregon *(Section 101-137 O.C.L.A.)* contemplates in ascertaining the liabilities of an insurance company the amount of total unearned premiums on the policies in force, and authorizes the Insurance Commissioner of Oregon to make any

necessary rules, regulations or orders with respect to reserves or unearned premium liability.

(f) An order of the Insurance Commissioner of Oregon has the same force and effect as the statute, provided such an order is within the contemplation of the statute.

(g) The courts have held that a reserve for unearned premiums in the title insurance business is deductible for income tax purposes when required by state regulation, and where such reserve is withheld only for a stated period of time and then again released for corporate purposes.

(h) The entire deduction of $46,889.63 should be allowed as a deduction in 1945 as the Title and Trust Company was not required prior to that year to set up any reserve for "unearned premiums".

SUMMARY OF ARGUMENT

The Respondent in this case was required under the provisions of the Oregon statutes to comply, not only with the statutes, but with the regulations of the Insurance Commissioner, and a failure to do so could result in a suspension of its right to do business. The order of the Insurance Commissioner pursuant to the statutes of Oregon was made in the best interests of policy holders and when such an order is made and a portion of the premium reserved for a limited time and there-

after freed from restrictions after which it may be used for general corporate purposes, is a sound policy and within the scope of general insurance regulation. Such provisions are contemplated within the tax laws of the United States which permit a deduction of such a reserve for unearned premiums by insurance companies other than life or mutual. Such deduction for tax purposes is justified when such portion of the income is not to be used for a limited time for general corporate purposes.

ARGUMENT

Title and Trust Company was entitled to deduct under *Section 204 (b) of the Internal Revenue Code* the amount set up in a reserve for unearned premiums as required by the order of the Insurance Commissioner of Oregon issued pursuant to the statutes of Oregon.

Federal Statutes and Decisions

Under the Internal Revenue Code special statutory provisions are made with respect to insurance companies and divides them into three classes. Certain statutes are provided for life insurance companies. Other statutes are provided for mutual insurance companies, and a third classification is made for insurance companies other than life or mutual. The Title and Trust Company in this case is under the latter classi-

fication and is covered by the provisions of *Section 204 of the Internal Revenue Code.* The applicable provisions of *Section 204 of the Internal Revenue Code* are as follows:

"(b) DEFINITION OF INCOME, ETC. In the case of an insurance company subject to the tax imposed by this section:

(1) GROSS INCOME: 'Gross income' means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under Section 22; except that in the case of a mutual fire insurance company described in paragraph (1) of subsection (a) of this section, the amount of single deposit premiums paid to such company shall not be included in gross income; * * * * *

(4) UNDERWRITING INCOME: 'Underwriting income' means the premium earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) PREMIUMS EARNED: 'Premiums earned on insurance contracts during the taxable year' means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year.

For the purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in section 201 (3) (2), pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by this section and not qualifying as a life insurance company under section 201 (b);"

There appears to be no dispute as to the Title and Trust Company in this case being engaged in the insurance business and taxable as an insurance company under the above statute. *U. S. v. Home Title Insurance Company, 285 U. S. 191, 52 S. Ct. 319, 76 L. Ed. 695.*

Several cases have dwelt upon the question of reserves for unearned premiums and each will be discussed herein.

In *American Title Co. v. Commissioner(CCA-3)76 Fed. 2d. 332* reserves were set up under a statute of Pennsylvania. The trust company engaged in title insurance business was absorbed by a national bank. The national bank was not authorized to conduct title insurance business. A new company was formed for insurance titles and a premium of $25,000 paid by the bank in consideration of the assumption by the new company of all liability on the $36,000,000 of outstanding policies. A reserve fund was set up for the protection of policyholders as required by the laws of Pennsylvania and deducted from the gross income on a federal tax return. In that case the court held that the re-

serves were not deductible, and it will be observed also that the reserves under the Pennsylvania statute were never to be returned until the last outstanding policy of the company had died. Such a decision is quite different from the instant case where the reserve was only to be set up for a period of 180 months.

In *City Title Insurance Co. v. Commissioner (CC A-2) 152 Fed. 2d. 859* a similar ruling was made with respect to unearned premiums set up under a New York statute. The New York statute made no limitation upon time for such reserves and reserves would never be returned to the insurance company. The matter of permanent reserves seems to be the determining point in a case. In the opinion of the court reference was also made to the *American Title Co.* case, supra, and also the case of *Early v. Lawyers Title Insurance Co. (CCA-4) 132 Fed. 2d. 42,* infra. In the City Title case the deduction of reserves applied only to the years 1938 to 1941, inclusive. From the court's decision it is apparent that the New York statute was amended in 1945 to apply to unearned premium reserves and reinsurance reserves to be held for a limited time of 180 months. The court did not attempt to decide the effect of the amendment as the taxes involved were all prior to the time of the amendment.

In *Early v. Lawyers Title Insurance Co. (CCA-4) 132 Fed. 2d. 42* a deduction for unearned premiums

was made pursuant to the statute of Virginia. At the time the Virginia act went into effect in 1936, the company set up a reserve of $66,942.81 covering contracts outstanding at the date the act became effective and added thereto $29,577.86 from premiums received during the remainder of the year. The Commissioner of Internal Revenue rejected the contention that the company was entitled to a deduction of the reserve as representing unearned premiums and assessed deficiencies. Mr. Justice Parker in delivering the opinion to the court said:

"The contention of the appellant is that premiums paid for title insurance are earned when received, that there is no basis for treating any part of such premiums as unearned and that the effect of the statute of Virginia is to provide a mere solvency reserve which the company is not entitled to treat as unearned premiums. Appellant is undoubtedly correct in the position that ordinarily a premium paid for title insurance is to be treated as fully earned when received. American Title Co. v. Commissioner of Internal Revenue, 3 Cir. 76 F. 2d. 332; Huebner on Property Insurance, p. 493. And in the absence of the Virginia statute relied on by the company we should feel constrained to hold that no part of the premiums received for title insurance could be treated as 'unearned' within the meaning of the section of the Revenue Act above quoted.

"As said by the Circuit Court of Appeals of the 5th Circuit in Commissioner of Internal Revenue v. Dallas Title & Guaranty Co., 119 F. 2d. 211, 213, however, 'it is not impossible for premiums paid a title insurance company to be earned.' Unquestionably the premium collected for title insurance is not all clear profit or income to the company immediately upon its receipt. As a matter of

fact, there is a time element as well as the element of contract to be considered in connection with the risk assumed in this type of insurance as well as in other types; and if any portion of the premiums, in consideration of the time element, is given, either by law or contract, the status ordinarily accorded an unearned premium in insurance law during any portion of the period for which the risk is operative, there is no reason why it should not be treated as an 'unearned' premium within the meaning of the taxing statute during this period. We think that the Virginia statute has this effect.

"The liabiliy under a title insurance policy, which in the case of this company is shown under the law of averages to be around 6% of the premiums collected, is outstanding as a continuing liability of the company to the policyholders; and, in recognition of this fact, the Virginia statute requires that a certain portion of the premiums, 10%, be set aside and held intact for a period of time for the discharge of this liability. The sums thus set aside 'at all times and for all purposes' are, by mandate of the statute, to 'constitute unearned portions of the original premiums'. This means that they are not available to the company for its ordinary purposes, until the times limited in the statute have expired, but, until then, are held in trust for the benefit of the contract holders. If the company should in the meantime become insolvent, they would be available as unearned premiums for reinsurance of the contracts, or if not used for that purpose would belong to the contract holders. Johnson v. Button 120 Va. 339, 91 S. E. 151, 153, Lovell, v. St. Louis Mutual Life Ins. Co., 111 U. S. 264, 274, 4 S. Ct. 390, 28 L. Ed. 423,; 32 C.J. p. 1040.

"There is no reason why the legislature may not thus require the company to deal with a portion of the premiums collected, just as, in the absence of contract between the parties, it may provide how the policy is to be valued for the purpose of setting up a reserve. Cf. 32 C. J. 1017; Elder v. Bankers'

Life Ins. Co., 117 App. Div. 722, 102 N. Y. S. 702. If the statute had provided that 10% of the premiums collected should be held for the benefit of policyholders for a fixed period and should belong to the company only after it had carried the liability for that period, it would hardly be contended that this portion of the premiums was earned within the meaning of the Revenue Act until the expiration of the period; but this is precisely the effect of the Virginia statute in providing that the sums required to be placed in reserve 'shall at all times and for all purposes be considered and constitute unearned portions of the original premiums'.

"Very much in point is the decision of the Circuit Court of Appeals of the First Circuit in Massachusetts Protective Ass'n. v. United States, 1 Cir., 114 F. 2d. 304, 213. That case involved the right to deduct as unearned premiums a reserve required by law to be kept by an accident and health insurance company. In that case, as in this, there was no provision for cancellation or for return of any part of the premium to the insured. In upholding the right to deduct this reserve as unearned premiums, notwithstanding that there was no requirement that anything be returned to the policyholder, the court said:

'Congress is only interested in determining what part of a company's gross income should be treated as net income for the purposes of taxation. McCoach v. Insurance Co. of North America, 1917, 244 U. S. 585, 37 S. Ct. 709, 61 L. Ed. 1333. In general, premium income is not such, and its inclusion in gross income is only justified by the deductions allowed. See Hearings before the Committee on Ways and Means on the Revenue Act of 1918, 65th Cong., 2nd Sess., Pt. 1 (1918) 811. The additional reserve for non-cancellable health and accident policies, whether returnable to the insured or not, is not available for the use of the general purposes of the plaintiff. It is held as a liability to provide for the payment or reinsurance of specific

> contingent insurance liabilities proven by experience to be a part of the cost of this particular type of insurance in the future years. * * * * As long as these reserve funds must be held to provide for expected insurance liabilities in the future on these non-cancellable health and accident policies and are not to be used for the general purposes of the company, they are not 'earned premiums' within the meaning of Congress and not includible in gross income. The test is not whether the part of the premium set aside in the reserve for non-cancellable health and accident insurance 'belongs' to the company in the event of cancellation or lapsing of the policy, but whether that amount is such a part of the company's gross income as Congress considered should be treated as net income for the purposes of taxation. McCoach v. Insurance Co. of North America, supra. We hold that it is not'."

The distinction between cases is very definitely shown. In those cases where the reserve is set up for an indefinite period of time or perpetuity, it has not been considered as a deductible item under *Section 204 of the Revenue Code.* However, in those cases where it is set up pursuant to statutory authority and for a limited period of time to cover the liability for unearned premiums and particularly to provide for any necessity of reinsurance and under a system where eventually the reserve is released for corporate purposes, the deduction of such a reserve is proper.

The court will note in the case of *Commissioner v. Dallas Title and Guaranty Co. CCA-5 119 Fed. 2d. 211,* where reserves were set up under the statutes of

Texas during a period of years and where the title insurance company had made deductions on its income tax returns for the credit made up of unearned premiums that these same funds became income when the same were released. Some of the funds involved became released to the title insurance company in 1934, and the title insurance company then took the position that the releasing of the reserve for corporate purposes did not constitute income. The court held that this much of the reserve which was returned became earned income under the satute.

See also *Utah Home Fire Insurance Company v. Commissioner 64 Fed. 2d. 763; Geyer, Cornell & Newell, Inc., 6 T. C. 96.*

After reading the above cases one can come to no other conclusion than that of finding a reserve for unearned premiums, as required in the present case, to be a deductible item and should not be included as earned income, provided such a reservation is not permanently taken away from the corporation but is only set aside in reserve for a limited time to cover any possible losses or, if necessary, for purposes of reinsurance.

State Statutes

The order of the Insurance Commissioner of Oregon, supra, and of which a copy is incorporated in the Stipulation of Facts, was premised upon authority given to the Insurance Commissioner by the statutes of Oregon. The insurance code of Oregon is embodied in *Title 101 of Oregon Compiled Laws Annotated* (herein sometimes referred to under its usual abbreviation of O. C. L. A.). The insurance code of Oregon sets out first general statutes covering the regulation of all forms of insurance. Thereafter specific statutes make additional regulations with respect to particular kinds of insurance such as life insurance, mutual companies, fraternal benefit societies, accident and health, hospital associations, marine insurance and others. The specific statutes which relate to title insurance companies are embodied in *101-1501 to 101-1505* O. C. L. A., inclusive, although such specific statutes do not have any particular bearing upon the issues arising in this case. The general insurance statutes covering all forms of insurance do have such a bearing.

The statutes of Oregon are set forth in the Appendix. Under *Section 101-105 O.C.L.A., sub-division (1)*, the Insurance Commissioner is authorized to *"issue such department rulings, instructions and orders as he may deem necessary to secure the enforcement of the provisions"* of the Act.

Under *Section 101-107 O. C. L. A., sub-divison* (7), an insurance company is permitted to transact insurance in the State of Oregon upon its compliance with the laws of this state *"and the regulations of the Insurance Department relating to such companies"*, and the payment of the necessary fees. It is further provided that the certificate to do business may be revoked on thirty days' notice by the Insurance Commissioner, or he may suspend the same temporarily if its capital is found to be impaired or if the required surplus has not been maintained, or if its transactions have been found to be in violation of the law.

The Insurance Commissioner has the authority to examine into the affairs of the company as provided in *Section 101-036 O. C. L. A.*, and has the right under *Section 101-307, O. C. L. A.* to require reserves, including a sum equal to the total unearned premiums on the policies in force, computed on a pro rata basis, and such an amount as may be necessary as a reserve to provide for the future payment of deferred and unearned claims for losses and promised benefits.

Pursuant to these statutes the Insurance Commissioner of Oregon made an examination as of September 30, 1945 of the Title and Trust Company. Such examinations are required at least once every three years under the statute. It is obvious from the order of the Insurance Commissioner that he made a very exhaustive study with respect to determination of an

adequate reserve for unearned premiums, including an analysis of the statutes of the various states, the trend and experience of the Title and Trust Company, the premium volume, and the size and types of risks underwritten, and then proceeded to establish a reserve based upon 3% of the total gross fees and premiums, and required such a reserve to be set up based upon the gross fees and premiums received from 1942 to 1945 inclusive, and to continue to make such reservation each month beginning with January of 1946. This reserve apparently was the result of an actuarial study made by the Insurance Commissioner of Oregon. This is not a permanent reserve, but is only to be held for a period of 180 months and thereafter would become released for corporate purposes. At the end of 180 months whatever is released for corporate purposes would become taxable income to the Title and Trust Company, but it is not taxable income during the year in which the reservation is made.

Title insurance, particularly in the West, is a system of evidencing titles which has practically supplanted the making of abstracts. In the last quarter of a century it has grown to a rather sizable business. As in all other parts of the country, property values materially and progressively increased, beginning with the years about 1941 and 1942. Inasmuch as the Title and Trust Company issues its policies in an amount equal to the purchase and sale price of properties, the

liability of the Title and Trust Company on its outstanding policies increased tremendously beginning with 1941. In view of this increased liability and in order to give a maximum of protection to the policyholders, the Insurance Commissioner was prompted to take such facts into consideration and order a reserve for unearned premiums.

It is asserted by the Commissioner of Internal Revenue that in order to be deductible for income tax purposes such a reserve is required to be established by statute rather than by order of the Insurance Commissioner. The Insurance Commissioner made his order under the authority given him to issue departmental rulings, instructions and orders as he may deem necessary as provided in *Section 101-105 O. C. L. A.* If such orders and regulations are not followed, the Insurance Commissioner has the right to suspend or revoke the permit of the Title and Trust Company under the provisions of *Section 101-107 O. C. L. A. Section 101-137 O. C. L. A.* gives the Insurance Commissioner specific authority in connection with the examination of insurance companies to provide for a reserve for unearned premiums. The only question remaining in connection with such an order is whether or not such a delegation of authority has the same legal effect as a statute.

After several decades of a gradual transition from substantive common law into legislative law and from

legislative law into administrative law, no one can close his eyes to the fact that administrative bodies in this decade are properly delegated with authority to make examinations, determine facts and issue rules and regulations, and if the rules and regulations are not contrary to the Constitution and statutes, they have the same force and effect as a statute enacted by the legislative body which delegated such authority.

The constitutionality of the Oregon insurance statutes has been upheld in the case of *Herbring v. Lee, 126 Or. 588, 269 Pac. 236,* and affirmed by the United States Supreme Court, *280 U. S. 111, 50 S. Ct. 49, 74 L. Ed. 217.*

Title insurance business under the statutes of Oregon has been held to be within the provisions of the general insurance laws. *Title and Trust Co. v. Wharton, 166 Or. 612, 144 Pac. 2d. 140.*

Effect of Orders and Regulations of Regulatory Bodies

In the evolution of law it has been determined that certain powers and duties may be delegated by a legislative body to an executive officer or administrative board, including the right to make such rules and regulations as may be necessary to carry into effect the

primary general laws enacted by the legislature. See *11 A. J. 945, Sec. 232* which states among other things the following:

> "Every executive officer, when called upon to act in his offical capacity, must inquire and determine whether, on the facts, the law requires him to do one thing or another, for all laws are carried into execution by officers appointed or elected for the purpose. Hence, such officers are clothed with a power which often necessarily involves in a large degree the exercise of discretion and judgment. It is definitely settled that there are no constitutional objections to the exercise of such discretion by administrative officers."

Also in *11 A. J. 949, Sec. 234,* is is pointed out that:

> "The modern tendency is to be more liberal in permitting grants of discretion to administrative bodies or officers in order to facilitate the administration of laws as the complexity of economic and governmental conditions increases."

Also in *11 A. J. 955, Sec. 240,* we find the following:

> "One of the most important limitations on the general prohibition of the delegation of legislative power to executive officers consists of a recognition of the right of the legislature under certain circumstances to delegate to executive or administrative officers and boards authority to promulgate rules and regulations. The authority to make rules and regulations to carry out an express legislative purpose or to effect the operation and enforcement of a law is not an exclusively legislative power, but is rather administrative in its nature."

Also in *11 A. J. 959, Sec. 241,* the following is stated:

> "Situations in which the various lawmaking bodies have delegated to administrative officers or boards the power to make regulations and to prescribe the necessary details to effectuate the declared policy of the law are very numerous and constantly increasing. Statutes conferring the power on executive officers to establish rules and regulations may be enacted by Congress, as well as by a state legislature; and this power may be conferred not only on executive officers, but also on administrative boards."

The Oregon Supreme Court in several decisions has upheld the right of regulatory bodies to make orders, rules and regulations, and to enforce them as to those who are regulated. In *White v. Mears, 44 Or. 215, 74 Pac. 931,* the court upheld the rights of the Commissioner for licensing sailors' boardinghouses to determine who might be licensed thereunder. In *State v. Briggs, 45 Or. 366, 77 Pac. 750, 78 Pac. 361,* the court upheld the right of a State Barber Board to prescribe qualifications of barbers. In *Stettler v. O'Hara, 69 Or. 519, 139 Pac. 743,* the court upheld the right of the Industrial Welfare Commission of the State to make an order fixing minimum wages and maximum hours of labor for women and minor workers in the City of Portland which was affirmed by the United States Supreme Court on writ of error, *243, U. S. 629, 37 S. Ct. 475, 61 L. Ed. 937.* In *State v. Terwilliger, 141 Or. 372, 11 Pac. 2d. 552, 16 Pac. 2d. 651* the court upheld the right of the Corporation Commissioner to make regulations for the sale of securities.

In *Cancilla v. Gelhar 141, Or. 184, 192, 27 Pac. 2d. 179* the court upheld the right of the State Department of Agriculture to receive and enforce delegated authority. In *Savage v. Martin, 161 Or. 660, 91 Pac. 2d. 273* the court upheld the right of the Milk Control Board to fix minimum prices and other regulatory authority with respect to the sale of milk.

We have no doubt but what the Oregon Supreme Court, if confronted with the question of the right of the Insurance Commissioner to make valid regulatory orders would be upheld as in all of the foregoing cases. The right of a state to regulate the insurance is beyond question. *29 A. J. 59, Sec. 22. 29 A. J. 61, Sec. 24* reads as follows:

> "Supervisory and Regulatory Boards of Officials. In most states, provision has been made for the creation or appointment of insurance boards, superintendents, or commissioners whose general duty and function it is to regulate and supervise the transaction of insurance business within the state so as to protect the interest of the public, to make uniform rates, to execute the insurance laws, and to see that violations of the insurance laws are properly dealt with or punished. Statutes which provide that such boards or officials shall have the power and duty to execute the insurance law of the state; to regulate and review rates of insurance; to require the submission of protective devices to tests before recognizing them as efficient factors for a lowering of fire insurance rates; to license or refuse, for cause to license insurance agents and brokers, provided statutory requirements are observed and the action of the official in such respect is not arbitrary; to serve as a statutory receiver or liquidator of insurance

companies; to approve or disapprove the amendment of the by-laws of insurance companies, have generally been upheld or recognized as constitutional and as a proper delegation of administrative or ministerial duties, rather than of legislative powers. In some cases or under some statutes, the superintendent of insurance may have the power to revoke or withhold the license or the renewal of the license of an insurance company or to examine insurance companies with reference to their assets, financial condition, and methods of doing business. The powers of a state superintendent of insurance to require that the salaries of officers of mutual insurance companies be reasonable and based upon sound business practice and to require restitution of excessive and exorbitant amounts so paid have been upheld. It has, moreover, been decided that the fact that legislative powers may have been unconstitutionally delegated to the state superintendent of insurance does not affect the validity of administrative acts performed by him without exercising legislative power or of statutes giving him administrative powers."

We also note that the United States District Court for the Western District of Texas in the case of *Petroleum Casualty Co. v. Frank Scofield, Collector of Internal Revenue,* decided August 19, 1947 (reported in CCH 1948 Vol. 5, p. 12,442, par. 9216) held that the Commissioner of Internal Revenue erred in disallowing a deduction taken by a workmen's compensation insurance company of the amount by which the taxpayer increased its reserves for unpaid claims *pursuant to an order of a state board.*

Another cogent example of a right of a legislative body to delegate authority to a board, commission or

executive officer is found in *Section 3791 of the Internal Revenue Code* under which the Commissioner of Internal Revenue is given the power to prescribe and publish all needful rules and regulations for the enforcement of the revenue laws, and such rules and regulations and the determinations of the Commissioner have been given great weight by the courts.

From the foregoing authorities it appears to be certain that the Insurance Commissioner of Oregon has full and ample authority to make the order which he promulgated on December 26, 1945, supra. The order by its own terms is not arbitrary or capricious but based upon a sound investigation of the facts and circumstances, and in the event that it is not complied with by the Title and Trust Company, we feel certain that Title and Trust Company would be deprived of its right to engage in the title insurance business in Oregon.

Unearned Premiums or Reinsurance Reserve

In connection with the order of the Insurance Commissioner, we trust that the court will not become confused in any way with the reference made to the guaranty fund deposited with the State Insurance Commissioner or the voluntary reserve accumulated by the Title and Trust Company. The guaranty fund Stipulation page 7, par. 9) of $100,000 of securities deposited with the State Insurance Commissioner is a

statutory qualification before the Title and Trust Company can engage in the business of writing title insurance in the State of Oregon. This limit of $100,000 has been in effect since 1919. The voluntary reserve of $50,000 referred to in the Stipulation of Facts (page 6, par. 8) is a reserve accumulated under the authority and direction of the Board of Directors of Title and Trust Company. The Insurance Commissioner of Oregon when he made his examination in 1945 and promulgated his order requiring an additional reserve for unearned premiums had the benefit of knowing from his own examination that the $100,000 in securities as a guaranty fund was deposited with the State, and that the company had a voluntary reserve of $50,000, and in his opinion these reserves were not sufficient to adequately cover the reserve provision for unearned premiums as the Insurance Commissioner points out in his order.

The Commissioner of Internal Revenue in the Pacific Abstract Title Company brief (page 13) dwells upon certain definitions of "premium," "unearned," and "unearned premiums." We agree with the Commissioner in saying that such terms are required to be used in their ordinary meaning. However, the term "unearned premiums" does not merely mean that it is a portion of the premium paid by a policy holder which must be returned on cancellation of the policy. It may be such portion of the premium set up in a

reserve to pay a claim for losses covered by the policy. It is ordinarily defined "as that portion of the premium which the company has not yet had time to earn." See *National Mutual Church Insurance Co. v. McGill (Ill.) 29 NE 2d. 306, 308.* As pointed out in the opinion in *Aetna Insurance Co. v Hyde, 315 Mo. 113* (cited in the Commissioner's brief, page 13), the court will discover upon reading the opinion that it definitely pointed out that the unearned premium was not limited to what was returned to the policyholder in case of cancellation. The opinion pointed out that the cost of procuring insurance was approximately 40% of the premium paid, and that the unearned premium was a liability instead of an asset, yet the company had collected unearned premium and had the cash in hand. The cost of procuring it had been paid or incurred and it was subject only to the hazard of future losses and possibly occasional cancellation.

If one analyzes carefully the title insurance business, there would be no question but what a portion of the premium represented the cost of searching the title and preparing the title insurance policy, including the expert help in such an endeavor, and would also include the usual portion of the cost of administration and supervision. In addition, however, a portion of the permium covers the risk involved. The Commissioner in his brief takes the position that the risk is of no longer duration than the issuance of the policy.

This, however, is not the case. In title insurance the risk persists through the years although it is diminished from time to time by reason of the statutes of limitations, laches and estoppel, and other common or statutory law which might terminate the right of possible claimants against the real property upon which the insurance is written. For instance, the statutes of limitations in Oregon found in *Title 1, Chapter 2, Section 1-201, et seq. O. C. L. A.,* makes various provisions for terminating the right of action, the longest of which is ten years. Some rights concerning real property would persist for a longer period of time, particularly where they involved rights of minors, insane persons or others under disability, or the sovereign state, where longer limitations apply by reason of common law or statutory exemptions from the ordinary limitations. The risk on a title insurance policy is not fixed and determined necessarily at the time of issue, but may arise at any time in the future, although the hazards thereof diminish with the passing of time. This perhaps is one of the reasons why the Insurance Commissioner felt that an order was necessary to protect policyholders on liabilities which might arise under these policies in the future as well as provide for the reinsurance of the policies in the event that the insuror for any reason went out of business, or for any other reason that would call for reinsurance. Such action on the part of the Insurance Commissioner was

undoubtedly premised upon proper foresight and a knowledge of the conditions of the community and the extent of the business written by the Company and the obligations assumed under the title insurance policies. It appears to be common knowledge that the Pacific Northwest, and particularly Oregon and Portland, have experienced substantial growth in the past decade and this fact must have been taken into consideration by the Insurance Commissioner. The fact itself would be very apparent that the title insurance companies in the area were assuming liabilities far in excess of those which had been assumed in previous years, and that the statutory reserve or deposit with the Insurance Commissioner, and in the case of Title and Trust Company, the voluntary reserve set up by its Board of Directors, appeared to the Insurance Commissioner to be insufficient to cover all of the contingencies which might arise by reason of the increased liabilities under the title insurance policies issued in the last several years. The Insurance Commissioner apparently, with wisdom and foresight, felt that the growth of the community, and the extent of liability on title insurance policies would increase rather than decrease, having in mind that all property values in the country had greatly increased, and particularly so in the Pacific Northwest. Title insurance policies are premised upon property values.

The delegation of authority to the Insurance Com-

missioner to determine how the premium should be prorated is one of the facts which the Insurance Commisioner determined by his examination and order and was not a delegation of legislative authority. The Insurance Commissioner is in a far better position to determine the pro rating, or in other words, the amount or portion of the gross fees and premiums to be set aside as a reserve for unearned premiums and for reinsurance. This he has done conservatively at the rate of 3%, and required that portion of the premiums for the years 1942 to 1945, inclusive, to be set up in the special reserve for unearned premiums, and the same procedure to be followed in subsequent years.

We do not believe it is incumbent upon the Title and Trust Company to test such an order before all the courts of Oregon before the same could be allowed as a deduction for income tax or excess profits tax purposes. Although it may be somewhat of a hardship for a corporation to have part of its earnings frozen or placed in a reserve for a period of time, and not be available for general corporate purposes, it appeals to sound reason and judgment that such a reserve as required by the State Insurance Commissioner was necessary. Eventually after the expiration of 180 months referred to in the order of the Insurance Commissioner, these amounts, or at least the unused portion theeof, will become available to the company as earnings without any restrictions as to their use for general corporate

purposes and will then become a part of the corporate income for tax purposes. It was held in the case of *Commissioner v. Dallas Title and Guaranty Co. (CCA-5) 119 Fed. 2d. 211,* that such premiums when made available for general corporate purposes at the expiration of the time limit, then become income subject to taxation by the Federal Government. See also *Commissioner v. Monarch Life Insurance Co., CCA, 114 Fed. 2d. 314.*

Also in *American Insurance Co. of Texas v. Thomas, (CCA), 146 Fed. 2d. 434,* it was pointed out that "it could hardly be maintained that a premium was entirely earned if there yet remained something to be done in later years by the insuror as a part of the consideration of its receipt," and accordingly held that it could not be characterized as *earned* premiums under *Section 204 of the Internal Revenue Code.*

A similar holding was made in *Massachusetts Protective Association v. U. S. (CCA) 114 Fed. 2d. 304.*

A good definition of reserves is given by the United States Supreme Court in the case of *Maryland Casualty Company vs. United States, 251 U. S. 342, 64 Law Ed. 297, 303,* where the court stated:

> "Reserves, as we have seen, are funds set apart as a liability in the accounts of a company to provide for the payment or reinsurance of specific,

contingent liabilities. They are held not only as security for the payment of claims, but also as funds from which payments are to be made. The amount 'reserved' in any given year may be greater than is necessary for the required purposes, or it may be less than is necesary, but the fact that it is less in one year than in the preceding year does not necessarily show either that too much or too little was reserved for the former year—it simply shows that the aggregate reserve requirement for the second year is less than the first, and this may be due to various causes. If, in this case, it were due to an overestimating of reserves for 1912, with a resulting excessive deduction for that year from gross income, *and if such excess was released to the general uses of the company and increased its free assets in 1913, to that extent it should very properly be treated as income in the year in which it became so available, for the reason that in that year, for the first time, it became free income, under the system for determining net income provided by the statute,* and the fact that it came into the possession of the company in an earlier year in which it could be used only in a special manner, which permitted it to become non-taxable, would not prevent its being considered as received in 1913 for the purposes of taxation within the meaning of the act." (Emphasis ours.)

The simple question in this case has not only been answered conclusively by the case of *Early vs. Lawyers Title Insurance Corporation, 132 Fed. 2d. 42,* but the point was actually decided prior to said decision and confirmed since.

The chronology on the cases on this particular point are as follows:

New Hampshire Fire Insurance Co. 2 T. C. 708,

which was affirmed by the Circuit Court of Appeals, First Circuit, in *Commissioner of Internal Revenue v. New Hampshire Fire Insurance Company, 146, Fed. 2d. 697.*

The above decision was followed by the decision in *Early v. Lawyers Title Insurance Corporation, CCA (4), 132 Fed. 2d. 42.*

In that case many of the same arguments were used as the Commissioner asserts in the instant case, and were answered by the court as follows:

"(6) It is argued that the term 'unearned premiums' in the taxing statute must be given its ordinary meaning. This is undoubtedly correct; but so also must the term as used in the statute of Virginia, and when given that meaning there its effect is to impress upon the portions of the premiums reserved the characteristics which bring them within the meaning of the term as used in the taxing statute.

"(7) The argument is made that to permit the deduction of the reserve set up under the Virginia statute will destroy uniformity in the application of the tax law; but uniformity is not destroyed when the factual basis to which the statute is applied is changed. The statute is applied with uniformity when unearned premiums are deducted from underwriting income; and the law of the state giving the status of unearned premiums to the portion of the premiums required to be reserved merely provides a difference in the basis of fact as to what premiums are unearned. We must look to the law of the state to deermine the nature of the interest which the company has in the por-

> tions of the premiums reserved. Having determined this, we look to the federal statute to determine whether such interest is taxable thereunder. 'State law creates legal interests and rights. The federal revenue acts designate what interests or right, so created, shall be taxed'."

The above cases were followed by a suit in the United States District Court for the District of Maryland in the case of *Fidelity and Deposit Company of Maryland vs. U. S., (unreported but may be found in CCH Standard Federal Tax Reporter, 1950, Vol. 5, p. 12, 119 Par. 9106.)* In that case, the opinion points out that the plaintiff is an insurance company other than life or mutual, incorporated under the laws of the State of Maryland and was, therefore, subject to the statutes of the state pertaining to the regulations promulgated by the Maryland Insurance Commissioner. The Maryland Insurance Commissioner *by directive* issued in 1941, forbade companies doing business in the state to take credit for certain unauthorized reinsurance. The plaintiff complied with such directive and set up a reserve to cover the amount of the unauthorized reinsurance and deducted from income the amount of the reserve. In the years when this reserve for unauthorized insurance was taken down, the plaintiff paid an income tax on these amounts.

That decision was appealed to the United States Court of Appeals for the Fourth Circuit and was affirmed, *United States vs. Fidelity and Deposit Co.,*

177 Fed. 2d. 805, and a petition for rehearing denied, *178 Fed. 2d. 753.* The affirmance was premised upon the decisions in the *New Hampshire Fire Insurance Company case, supra,* and the case of *Early v. Lawyers Title Insurance Corporation, supra.*

This should conclusively answer the argument of the Commissioner that the order or directive of a regulatory body or official would not have the same effect as a statute.

We, therefore, respectfully submit that the reserve for unearned premiums set up in 1945 in the amount of $46,889.63 should be excluded from earned income of the Title and Trust Company for the year 1945.

Deduction of Full Liability in 1945

The only remaining question pertains to the full deduction in 1945 of the amount of $46,889.63 which represents the unearned premiums for the calendar years 1942, 1943, 1944 and 1945. This part of the argument is premised upon the assumption that the court will find the Title and Trust Company entitled to deduct a reserve for unearned premiums. The examination of the Insurance Commissioner of Oregon was made in 1945 and his order promulgated on December 26, 1945. Prior to December 26, 1945, there was no occasion for the Title and Trust Company to make any reservation of income for unearned premiums. During the years

1942, 1943, and 1944, the Title and Trust Company had no knowledge of any anticipated requirement that a reservation of income would be required by the Insurance Commissioner of Oregon.

Under the income tax statutes where a taxpayer is on the accrual basis, items of income are reported in full in the year in which they are earned. On the other hand, deductions or liabilities ordinarily cannot be taken or deducted until they become fixed or certain, and sometimes by an indentifiable event. The liability which results in a reservation of income for unearned premiums did not arise or become fixed until the order of the Insurance Commissioner of Oregon on December 26, 1945.

In *Lucas v. American Code Co., 280 U. S. 445, 50 S. Ct. 202, 74 L. Ed. 538, 67 A. L. R. 1010,* the United States Supreme Court held that damages for breach of a contract of employment recovered against a taxpayer accounting on the accrual basis are not deductible in the year in which the breach occurred where the amount was not determined or paid until later and which was contested and the amount was wholly unpredictable until the litigation was ultimately brought to a close.

Following this case the Supreme Court decided the case of *Lucas v. Ox Fibre Brush Co., 281 U. S. 115, 50 S. Ct. 273, 74 L. Ed. 733.* In the Ox Fibre case a

corporation granted extra compensation to its officers for services performed in prior years. The United States Supreme Court held that even though this payment was for services in prior years, it was a proper deduction in determining the taxable income of the corporation for the year in which the grant was made even though the books of the corporation were kept on an accrual basis. In its opinion the court referred to the sections of the income tax statute with respect to computing net income and stated as follows:

> "This section relates to the method of accounting; the commissioner may make the computation on a basis that does clearly reflect the income, if the method employed by the taxpayer does not. But this section does not justify the commissioner in allocating to previous years a reasonable allowance as compensation for services actually rendered, when the compensation was properly paid during the taxable year and the obligation to pay was incurred during that year and not previously. In the present instance, the expense could not be attributed to earlier years, for it was neither paid nor incurred in those years. There was no earlier accrual of liability. It was deductible in the year 1920 or not at all. Being deductible as a reasonable payment, there was no authority vested in the commissioner to disregard the actual transaction and to readjust the income on another basis which did not respond to the facts."

The accrual of a reserve to cover liability for unearned premiums is in the general category of other deductions and not entirely unlike the reasoning which is applied to debts ascertained to be worthless and

charged off. The right to take a deduction only exists in a year in which it becomes fixed or determined as pointed out by the Supreme Court in *Spring City Foundry Company v. Commissioner, 292 U. S. 182, 78 L. Ed. 1200.* This principle was further enunciated by the Supreme Court in *Security Flour Mills Company v. Commissioner, 321 U. S. 281, 64 S. Ct. 596, 88 L. Ed. 725* where the court said:

> "This legal principle has often been stated and applied. The uniform result has been denial both to Government and to the taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, or, applying the accrual basis, the year in which the right to receive, or the obligation to pay, has become final and definite in amount."

In the case of *Commissioner v. Blaine, Mackay, Lee Co., (CCA-3) 141 Fed. 2d. 201,* the court said:

> "Under the accrual system (here in use) income is accruable in the year in which the taxpayer's right thereto becomes fixed and definite, even though it may not be actually received until a later year, while a deduction for a liability is to be accrued and taken when the liability becomes fixed certain, even though it may not be paid until a later year."

See also *Central Trust Co. v. Burnet (CCA-DC) 45 Fed. 2d. 992; Early v. Lawyers Title Ins. Corp., 132 Fed. 2d. 42, 46.*

If the Title and Trust Company in 1945 had sought to open up its returns for the year 1942 to 1944, inclusive, and sought to deduct the portion of the reserve applicable to such years, there seems to be no question but what the Commissioner of Internal Revenue would promptly disallow such deduction. Under the reasoning of the above cases, even though there had been no fundamental question arising as to the deductibility of the reserve, the Commissioner would undoubtedly disallow such a deduction purely for the reason that the amount of such deduction did not become fixed and determined until 1945 when the order was made by the Insurance Commissioner of Oregon.

CONCLUSION

In conclusion we respectfully submit that the deduction of $46,889.63 should be fully allowed in the year 1945, and that this court should affirm the decision of the Tax Court of the United States.

Respectfully submitted,

CLARENCE D. PHILLIPS,
Attorney for Title and Trust Company

GRIFFITH, PHILLIPS & COUGHLIN
807 Electric Building
Portland 5, Oregon
Of Counsel

APPENDIX

7 OREGON COMPILED LAWS ANNOTED (1940):

"*Section 101-105, OCLA, Subdivision (1).* The insurance commissioner shall have and exercise the power to enforce all the laws of the state relating to insurance, and it shall be his duty to enforce all the provisions of such laws for the public good. He shall issue such department rulings, instructions and orders as he may deem necessary to secure the enforcement of the provisions of this act, but nothing contained in this act shall be construed to prevent any company or persons affected by any order or action of the insurance commissioner from testing the validity of same in any court of competent jurisdiction."

"*Section 101-105, OCLA, Subdivision (2).* (Issuance of certificates, etc.) He shall issue all certificates and licenses under the seal of his office provided for by the terms of this act. Before granting certificates of authority to any insurance company to issue policies or make contracts of insurance in this state, the commissioner shall be satisfied by such examination as he may make, or such evidence as he may require, that such company is duly qualified under the laws of this state to transact business herein."

"*Section 101-105, OCLA, Subdivision (3).* (Furnishing of form for financial statement.) Every insurance company, doing business in the state, shall file with the commissioner on or before March 1st of each year, a financial statement for the year ending December 31st immediately preceding on [a] form furnished by the commissioner, which shall conform as nearly as may be to the form of statement from time to time adopted by the national convention of insurance commissioners, and containing such detailed exhibit of the condition and transactions of the company as the

commissioner, in such form and otherwise shall reasonably prescribe. Such statement shall be verified by the oaths of the president and secretary of the company, or in their absence by two other principal officers. The statement of a company of a foreign country shall embrace only its condition and transactions in the United States, and shall be verified by the oath of its resident manager or principal representative in the United States. In the discretion of the commissioner a penalty of ten dollars per day shall attach for delinquency in filing such statement."

"Section 101-107, OCLA, Subdivision (7). Certificate of Authority of Domestic Companies. A domestic insurance company shall be granted a certificate of authority to transact any kind or class of insurance permitted by the provisions of the insurance laws of this state and provided for in its articles of incorporation upon its compliance with the laws of this state and the regulations of the insurance department relating to such companies and the payment of the fees and charges imposed by law, which certificate may be revoked on thirty (30) days' notice by the insurance commissioner, or he may suspend same temporarily if he deems necessary or advisable. Cause for revocation or suspension of such certificate shall exist if its capital is found to be impaired or the required surplus has not been maintained or if its transactions have been found to be in violation of the law."

"Section 101-136, OCLA. (Examination into affairs of company or persons in insurance business: Appointment of examiners: Duty to produce books and papers and to facilitate examination: Report of examiners: Hearing: Inspection and publication of report: Expenses of examination.) The insurance commissioner shall, whenever he deems it advisable in the interest of policyholders or for the public good, examine into the

affairs of any insurance company, agency, corporation, partnership, person or persons engaged in or proposing to engage in the insurance business in this state, and into the affairs of any company organization under any law of this state or having an office or representative in this state, which company is engaged in or is claiming or advertising that it is engaged in organizing or receiving subscriptions for or disposing of stock of, or in any manner aiding or taking part in the formation or business of an insurance company or companies, or which is holding capital stock of one or more insurance companies for the purpose of controlling the management thereof as voting trustee or otherwise. For such purpose he may appoint as examiners one or more fair, impartial and competent persons, not officers of, nor connected with nor interested in any insurance company other than as policyholders, nor in any other company above referred to, and upon such examination, he, his deputy or any examiner authorized by him may examine under oath the officers and agents of such company or agency and all persons deemed to have material information regarding the property or business of such company or agency. Every such company or agency, its officers and agents, shall produce at the office of the company or agency where the same are kept its books and all papers in its or their possession relating to its business or affairs, and any other person may be required to produce any book or paper in his custody relevant to the examination, for the inspection of the insurance commissioner, his deputies or examiners whenever required; and the officers and agents of such company or agency shall facilitate such examination and aid the examiners in making the same so far as it is in their power to do so. Every such examiner shall make a full and true report of every examination made by him, verified by his oath, which shall comprise only facts appearing upon the books, papers, records or documents of such company or agency or ascertained from the testi-

mony sworn to of its officers or agents or other persons examined under oath concerning its affairs, and said report so verified shall be presumptive evidence in any action or proceeding in the name of the people against the company or agency, its officers or agents, of the facts stated therein. The insurance commissioner shall grant a hearing to the company or agency examined before filing any such report and before making public such report or any matters relating thereto; and may withhold any such report from public inspection for such time as he may deem proper; and if said company or agency offers no objection at said hearing, it will be an admission of acceptance; and may, after so filing, if he deems it for the interest of the public to do so, publish any such report of the result of any such examination as contained therein in one or more newspapers of the state without expense to the company or agency. Any company or association doing business in Oregon shall pay the just and legitimate expenses, including railroad fares and traveling expenses of any examination; and the commissioner shall revoke or refuse his certificate of authority to any company neglecting or refusing to pay such expenses, or neglecting or refusing to furnish any information to said commissioner. It shall be the duty of the insurance commissioner to examine every domestic insurance company at least once in three years."

"*Section 101-137, OCLA.* Examination: Reserve: Liability: (Formulating or adopting rules). In ascertaining the conditions of an insurance company under the provisions of this act, or in any examination made by the insurance commissioner, his deputy or examiner, he shall allow as assets only such investments, cash and accounts as are authorized by the laws of this state at the date of the examination, or under the laws of the state or country under which such company is organized and which investment he may approve

or reject, but unpaid premiums on policies written within three months shall be admitted as available resources. In ascertaining his liabilities, unless otherwise provided in this act, there shall be charged the capital stock, all outstanding claims, a sum equal to the total unearned premiums on the policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. In determining the amount of such reserve or unearned premium liability, the insurance commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent with law or he may adopt such rules as are used in other states or approved by the national convention of insurance commissioners."

No. 12959

United States
Court of Appeals
for the Ninth Circuit.

C. ABBOTT LINDSEY and PAULINE LINDSEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court of the United States

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

DANA LATHAM, ESQ.,
AUSTIN H. PECK, JR., ESQ.,
H. C. DIEHL, ESQ.

For Respondent:

L. C. AARONS, ESQ.

The Tax Court of the United States
Docket No. 18396

C. ABBOTT LINDSEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:LHP) dated February 19, 1948, and as a basis of this proceeding alleges as follows:

I.

Petitioner is an individual residing at 1203 West Seventh Street, Los Angeles 14, California. Petitioner's income tax return for the period here involved was filed with the Collector of Internal Revenue for the Sixth District of California.

II.

The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A," was mailed to petitioner on February 19, 1948.

III.

The taxes in controversy are federal income taxes for the calendar years 1944 and 1945, as follows:

1944	$2,041.07
1945	2,867.32
Total	$4,908.39

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(1) The respondent erroneously computed the tax upon $4,400.00, representing petitioner's community one-half of $8,800.00 compensation for personal services paid to him and attributable to the years 1938 and 1939, upon the basis of including all of said sum in petitioner's 1944 income and taxing said entire amount at the rates applicable for the year 1944 rather than at the rates applicable for the years 1938 and 1939.

(2) Respondent erroneously failed and refused to compute the tax upon said $4,400.00 of income at the rates applicable for the years 1938 and 1939, to which years said income was attributable.

(3) The respondent erroneously determined that the provisions of Section 107 of the Internal Revenue Code are not applicable in the computation of petitioner's tax for the calendar year 1944 and erroneously failed and refused to apply said section in making such computation.

(4) The respondent erroneously computed the tax upon $5,750.00, representing petitioner's community one-half of $11,500.00 compensation for personal services paid to him and attributable to the years 1939 and 1940, upon the basis of including all

of said sum in petitioner's 1945 income and taxing said entire amount at the rates applicable for the year 1945 rather than at the rates applicable for the years 1939 and 1940.

(5) Respondent erroneously failed and refused to compute the tax upon said $5,750.00 of income at the rates applicable for the years 1939 and 1940, to which years said income was attributable.

(6) The respondent erroneously determined that the provisions of Section 107 of the Internal Revenue Code are not applicable in the computation of petitioner's tax for the calendar year 1945 and erroneously failed and refused to apply said section in making such computation.

V.

The facts upon which petitioner relies as a basis for this proceeding are as follows:

(1) During the years 1937 through 1945 and up to and including the present date, petitioner has been an officer of the Commodore Hotel Co., Ltd., 1203 West Seventh Street, Los Angeles, California. Said corporation keeps its books and files its income tax returns on the cash receipts and disbursements basis.

(2) By appropriate action of its board of directors, evidenced by proper corporate resolution, Commodore Hotel Co., Ltd., undertook and agreed to pay to petitioner monthly from and after January 1, 1937, a salary of $600.00 per month, said salary to continue monthly without interruption.

(3) During each of the years 1938, 1939 and 1940, said corporation suffered deficits from its operations and its capital was impaired. It owed substantial amounts to outside creditors. Because of its straitened circumstances it was unable, during each of said years, to pay to petitioner the full amount of salary which it had been authorized by its board of directors to pay, and which it had agreed to pay. The corporation, however, at all times recognized its liability for the full amount authorized to be paid to petitioner.

(4) During the year 1944 said corporation first found itself in a financial position which would permit it to pay to petitioner a portion of the back salary theretofore unpaid. During said year it actually paid to petitioner the sum of $8,800.00 on account of said back salary, which amount was attributable to the discharge, to the extent possible, of the unpaid salary of petitioner for the years 1938 and 1939.

(5) In preparing their federal income tax returns for the calendar year 1944 petitioner and his wife reported as community property the receipt of said $8,800.00 and computed the tax thereon in accordance with the provisions of Section 107(d) of the Internal Revenue Code. The respondent has refused to permit the application of said section of the Internal Revenue Code in the computation of petitioner's tax for said year.

(6) During the year 1945 said corporation paid to petitioner the sum of $11,500.00 on account of

said back salary, which amount was attributable to the discharge, to the extent possible, of petitioner's unpaid salary for the years 1939 and 1940.

(7) In preparing their federal income tax returns for the calendar year 1945 petitioner and his wife reported as community property the receipt of said $11,500.00 and computed the tax thereon in accordance with the provisions of Section 107(d) of the Internal Revenue Code. The respondent has refused to permit the application of said section of the Internal Revenue Code in the computation of petitioner's tax for said year.

Wherefore, petitioner prays that this court may hear this proceeding and determine:

(1) That respondent erred in the particulars set forth in paragraph IV of this petition.

Respectfully submitted,
/s/ DANA LATHAM,
/s/ AUSTÍN H. PECK, JR.,
/s/ HENRY C. DIEHL,
Counsel for Petitioner.

May 6, 1948.

State of California,
County of Los Angeles—ss.

C. Abbott Lindsey, being first duly sworn, deposes and says: That he is the petitioner in the foregoing petition; that he has read said petition and is familiar with the facts contained therein, and that

said facts are true and correct to the best of his knowledge and belief.

/s/ C. ABBOTT LINDSEY.

Subscribed and sworn to before me this 6th day of May, 1948.

[Seal] /s/ ISOBEL V. HUGHES,
Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires Nov. 4, 1948.

EXHIBIT A

Form 1279 (Rev. Mar. 1946) SN-IT-7

Treasury Department
Internal Revenue Service
417 South Hill Street
Los Angeles 13, California

February 19, 1948

Office of
Internal Revenue Agent in Charge
Los Angeles Division
LA:IT:90D:LHP
Mr. C. Abbott Lindsey
1203 West Seventh Street
Los Angeles 14, California
Dear Mr. Lindsey:

You are advised that the determination of your income tax liability for the taxable years ended

December 31, 1944 and 1945, discloses a deficiency of $4,908.39, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA: Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

GEO. J. SCHOENEMAN,
Commissioner,

By GEORGE D. MARTIN,
Internal Revenue Agent in
Charge.

Enclosures:
Statement
Form of Waiver

Statement

LA:IT:90D:LHP

Mr. C. Abbott Lindsey
1203 West Seventh Street
Los Angeles 14, California

Tax Liability for the Taxable Years
Ended December 31, 1944 and 1945

Year	Deficiency
1944 Income tax	$2,041.07
1945 Income tax	2,867.32
Total	$4,908.39

In making this determination of your income tax liability careful consideration has been given to the report of examination dated March 17, 1947.

Adjustment to Net Income
Taxable Year Ended December 31, 1944

Net income as disclosed by return	$21,841.76
Additional deduction:	
(a) Standard deduction	250.00
Net income adjusted	$21,591.76

Explanation of Adjustment

(a) In your return you elect to take the standard deduction provided in section 23 (aa)(1) of the Internal Revenue Code, but claim only $250.00 of the $500.00 allowable. An additional deduction of $250.00 is accordingly allowed.

In your return you disclose receipt in 1944 of compensation for personal services in the amount of $4,400.00 (your community half of $8,800.00) attributable to the years 1938 and 1939 which you include in gross income. However, in the computation of your tax this income is excluded and the tax attributable to such income, computed at the lower rates in effect for such prior years, is added to the amount computed without regard to such income, the total of which is reported as your income tax liability for 1944.

It has been determined that the provisions of section 107 of the Internal Revenue Code are not applicable, and that the aforementioned $4,400.00 constitutes income taxable at the rates in effect in the year received.

Computation of Alternative Tax
Taxable Year Ended December 31, 1944

Net income adjusted		$21,591.76
Less: Excess of net long-term capital gain over net short-term capital loss		1,550.09
Ordinary net income		$20,041.67
Less: Surtax exemption		500.00
Balance (surtax net income)		$19,541.67
Surtax on $19,541.67		7,017.09
Ordinary net income	$20,041.67	
Less: Normal tax exemption	500.00	
Balance subject to normal tax	$19,541.67	
Normal tax (3 per cent of $19,541.67)		586.25
Partial tax		$ 7,603.34
Plus: 50 per cent of $1,550.09		775.04
Alternative tax		$ 8,378.38

Computation of Tax
Taxable Year Ended December 31, 1944

Net income adjusted	$21,591.76	
Less: Surtax exemption	500.00	
Surtax net income	$21,091.76	
Surtax		$ 7,871.39
Net income adjusted	$21,591.76	
Less: Normal-tax exemption	500.00	
Net income subject to normal tax	$21,091.76	
Normal tax at 3%		632.75
Total normal tax and surtax		$ 8,504.14
Alternative tax		$ 8,378.38
Correct income tax liability		$ 8,378.38
Income tax liability shown on return, account No. 9020900		6,337.31
Deficieney of income tax		$ 2,041.07

Net Income
Taxable Year Ended December 31, 1945

The net income of $25,746.91 disclosed in your return is accepted as correct.

In your return you disclose receipt in 1945 of compensation for personal services in the amount of $5,750.00 (your community half of $11,500.00) attributable to the years 1939 and 1940. In the computation of your tax this income is excluded and the tax attributable to such income, computed at the lower rates in effect for such prior years, is added to the amount computed without regard to such income, the total of which is reported as your income tax liability for 1945.

It has been determined that the provisions of section 107 of the Internal Revenue Code are not applicable, and that the aforementioned $5,750.00 constitutes income taxable at the rates in effect in the year received.

Computation of Alternative Tax
Taxable Year Ended December 31, 1945

Net income		$25,746.91
Less: Excess of net long-term capital gain over net short-term capital loss		4,610.63
Ordinary net income		$21,136.28
Less: Surtax exemption		500.00
Balance (surtax net income)		$20,636.28
Surtax on $20,636.28		$ 7,616.32
Ordinary net income	$21,136.28	
Less: Normal tax exemption	500.00	
Balance subject to normal tax	$20,636.28	
Normal tax (3 per cent of $20,636.28)		619.09
Partial tax		$ 8,235.41
Plus: 50 per cent of $4,610.63		2,305.31
Alternative tax		$10,540.72

Computation of Tax
Taxable Year Ended December 31, 1945

Net income	$25,746.91	
Less: Surtax exemption	500.00	
Surtax net income	$25,246.91	
Surtax		$10,295.68
Net income	$25,746.91	
Less: Normal-tax exemption	500.00	
Net income subject to normal tax	$25,246.91	
Normal tax at 3%		757.41
Total normal tax and surtax		$11,053.09
Alternative tax		$10,540.72
Correct income tax liability		$10,540.72
Income tax liability shown on return, account No. 2381798		7,673.40
Deficiency of income tax		$ 2,867.32

Received and Filed T.C.U.S. May 11, 1948.

Served May 12, 1948.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I and II.

Admits the allegations contained in paragraphs I and II of the petition.

III.

Admits that the taxes in controversy are Federal income taxes for the calendar years 1944 and 1945; denies the remainder of the allegations contained in paragraph III of the petition.

IV.

(1) to (6), inclusive. Denies the allegations of error contained in subparagraphs (1) to (6), inclusive, of paragraph IV of the petition.

V.

(1) For lack of sufficient information as to the truth or correctness thereof denies the allegations contained in subparagraph (1) of paragraph V of the petition.

(2) and (3). Denies the allegations contained in subparagraphs (2) and (3) of paragraph V of the petition.

(4) Admits that during the year 1944 said cor-

poration paid to the petitioner the sum of $8,800.00; denies the remainder of the allegations contained in subparagraph (4) of paragraph V of the petition.

(5). Admits that in preparing their Federal income tax returns for the calendar year 1944 petitioner and his wife reported as community property the receipt of said $8,800. Further admits that respondent has held Section 107(d) of the Internal Revenue Code inapplicable in the computation of petitioner's tax for said year. Denies the remainder of the allegations contained in subparagraph (5) of paragraph V of the petition.

(6). Admits that during the year 1945 said corporation paid to the petitioner the sum of $11,500; denies the remainder of the allegations contained in subparagraph (6) of paragraph V of the petition.

(7). Admits that in preparing their Federal income tax returns for the calendar year 1945, petitioner and his wife reported as community property the receipt of said $11,500. Further admits that respondent has held Section 107(d) of the Internal Revenue Code inapplicable in the computation of petitioner's tax for said year. Denies the remainder of the allegations contained in subparagraph (7) of paragraph V of the petition.

VI.

Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES OLIPHANT, ECC.
CHARLES OLIPHANT,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

E. C. CROUTER,
A. J. HURLEY,
Special Attorneys, Bureau of
Internal Revenue.

Received and filed T.C.U.S. June 22, 1948.

[Title of Tax Court and Cause.]

Docket No. 18396

AMENDED PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:LHP) dated February 19, 1948, and as a basis of this proceeding alleges as follows:

I.

Petitioner is an individual residing at 1203 West Seventh Street, Los Angeles 14, California. Petitioner's income tax return for the period here in-

volved was filed with the Collector of Internal Revenue for the Sixth District of California.

II.

The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A," was mailed to petitioner on February 19, 1948.

III.

The taxes in controversy are federal income taxes for the calendar years 1944 and 1945, as follows:

1944	$2,041.07
1945	2,867.32
Total	$4,908.39

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(1) The respondent erroneously computed the tax upon $5,000.00, representing petitioner's community one-half of $10,000.00 compensation for personal services paid to him and attributable to the years 1937, 1938, and 1939, upon the basis of including all of said sum in petitioner's 1944 income and taxing said entire amount at the rates applicable for the year 1944 rather than at the rates applicable for the years 1937, 1938, and 1939.

(2) Respondent erroneously failed and refused to compute the tax upon said $5,000.00 of income at the rates applicable for the years 1937, 1938, and 1939, to which years said income was attributable.

(3) The respondent erroneously determined that the provisions of Section 107 of the Internal Revenue Code are not applicable in the computation of petitioner's tax for the calendar year 1944 and erroneously failed and refused to apply said section in making such computation.

(4) The respondent erroneously computed the tax upon $5,750.00, representing petitioner's community one-half of $11,500.00 compensation for personal services paid to him and attributable to the years 1939 and 1940, upon the basis of including all of said sum in petitioner's 1945 income and taxing said entire amount at the rates applicable for the year 1945 rather than at the rates applicable for the years 1939 and 1940.

(5) Respondent erroneously failed and refused to compute the tax upon said $5,750.00 of income at the rates applicable for the years 1939 and 1940, to which years said income was attributable.

(6) The respondent erroneously determined that the provisions of Section 107 of the Internal Revenue Code are not applicable in the computation of petitioner's tax for the calendar year 1945 and erroneously failed and refused to apply said section in making such computation.

(7) The respondent erred in failing and refusing to determine that petitioner has overpaid his income taxes for the calendar year 1944.

V.

The facts upon which petitioner relies as a basis for this proceeding are as follows:

(1) During the years 1937 through 1945 and up to and including the present date, petitioner has been an officer of the Commodore Hotel Co., Ltd., 1203 West Seventh Street, Los Angeles, California. Said corporation keeps its books and files its income tax returns on the cash receipts and disbursements basis.

(2) By appropriate action of its board of directors, evidenced by proper corporate resolution, Commodore Hotel Co., Ltd., undertook and agreed to pay to petitioner monthly from and after January 1, 1937, a salary of $600.00 per month, said salary to continue monthly without interruption.

(3) During each of the years 1937, 1938, 1939 and 1940, said corporation suffered deficits from its operations and its capital was impaired. It owed substantial amounts to outside creditors. Because of its straitened circumstances it was unable, during each of said years, to pay to petitioner the full amount of salary which it had been authorized by its board of directors to pay, and which it had agreed to pay. The corporation, however, at all times recognized its liability for the full amount authorized to be paid to petitioner.

(4) During the year 1944 said corporation first found itself in a financial position which would permit it to pay to petitioner a portion of the back salary theretofore unpaid. During said year it actually paid to petitioner the sum of $10,000.00 on account of said back salary, which amount was attributable to the discharge, to the extent possible,

of the unpaid salary of petitioner for the years 1937, 1938, and 1939.

(5) In preparing their federal income tax returns for the calendar year 1944 petitioner and his wife reported as community property the receipt of said $10,000.00 and computed the tax thereon in accordance with the provisions of Section 107(d) of the Internal Revenue Code. The respondent has refused to permit the application of said section of the Internal Revenue Code in the computation of petitioner's tax for said year.

(6) During the year 1945 said corporation paid to petitioner the sum of $11,500.00 on account of said back salary, which amount was attributable to the discharge, to the extent possible, of petitioner's unpaid salary for the years 1939 and 1940.

(7) In preparing their federal income tax returns for the calendar year 1945 petitioner and his wife reported as community property the receipt of said $11,500.00 and computed the tax thereon in accordance with the provisions of Section 107(d) of the Internal Revenue Code. The respondent has refused to permit the application of said section of the Internal Revenue Code in the computation of petitioner's tax for said year.

(8) Petitioner's income tax return for the calendar year 1944 disclosed a liability for taxes in the amount of $6337.31, which amount was paid on or before March 15, 1945. Petitioner's correct tax liability for said year 1944 is $5607.42. Petitioner

has overpaid his 1944 income taxes in the amount of $729.84, and refund of said amount is hereby claimed.

Wherefore, petitioner prays that this court may hear this proceeding and determine:

(1) That respondent erred in the particulars set forth in paragraph IV of this petition.

Respectfully submitted,
/s/ DANA LATHAM,
/s/ AUSTIN H. PECK, JR.,
/s/ HENRY C. DIEHL,
Counsel for Petitioner.

January 25, 1949.

State of California,
County of Los Angeles—ss.

C. Abbott Lindsey, being first duly sworn, deposes and says: That he is the petitioner in the foregoing petition; that he has read said petition and is familiar with the facts contained therein, and that said facts are true and correct to the best of his knowledge and belief.

/s/ C. ABBOTT LINDSEY.

Subscribed and sworn to before me this 7th day of February, 1949.

[Seal] /s/ LILLIAN S. FOLTZ,
Notary Public in and for the County of Los Angeles, State of California.

EXHIBIT A

[Exhibit A is identical to Exhibit A attached to the Petition (Docket No. 18396), and is set out at pages 8 and 9 of this printed record.]

Filed T.C.U.S. February 9, 1949.

Served March 1, 1949.

[Title of Tax Court and Cause.]

ANSWER TO AMENDED PETITION

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, for answer to the amended petition of the above-named taxpayer, admits and denies as follows:

I and II.

Admits the allegations contained in paragraphs I and II of the amended petition.

III.

Admits that the taxes in controversy are Federal income taxes for the calendar years 1944 and 1945. Denies the remainder of the allegations contained in paragraph III of the amended petition.

IV.

(1) to (7) inclusive. Denies the allegations of error contained in subparagraphs (1) to (7) inclusive of paragraph IV of the amended petition.

V.

(1). Admits the allegations contained in sub-

paragraph (1) of paragraph V of the amended petition.

(2). Admits that on April 14, 1937, the board of directors of Commodore Hotel Co., Ltd., authorized the payment of salary to petitioner in the amount of $600.00 per month commencing as of January 1, 1937. Denies the remainder of the allegations contained in subparagraph (2) of paragraph V of the amended petition.

(3). Admits that during each of the years 1937, 1938, 1939 and 1940, said corporation suffered deficits from operations and in its capital account. Denies the remainder of the allegations contained in subparagraph (3) of paragraph V of the amended petition.

(4). Admits that during the year 1944 said corporation paid to the petitioner the sum of $10,000.00. Denies the remainder of the allegations contained in subparagraph (4) of paragraph V of the amended petition.

(5). Admits that in preparing their Federal income tax returns for the calendar year 1944, petitioner and his wife reported as community property the receipt of said $10,000.00; further admits that respondent has held Section 107(d) of the Internal Revenue Code inapplicable in the computation of petitioner's tax for said year. Denies the remainder of the allegations contained in subparagraph (5) of paragraph V of the amended petition.

(6). Admits that during the year 1945 said corporation paid to the petitioner the sum of $11,-

500.00. Denies the remainder of the allegations contained in subparagraph (6) of paragraph V of the amended petition.

(7). Admits that in preparing their Federal income tax returns for the calendar year 1945 petitioner and his wife reported as community property the receipt of said $11,500.00; further admits that respondent has held Section 107(d) of the Internal Revenue Code inapplicable in the computation of petitioner's tax for said year. Denies the remainder of the allegations contained in subparagraph (7) of paragraph V of the amended petition.

(8). Admits that the amount of liability for taxes shown by petitioner on his income tax return for the calendar year 1944 was $6,337.31. Denies the remainder of the allegations contained in subparagraph (8) of paragraph V of the amended petition.

VI.

Denies each and every allegation contained in the amended petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES OLIPHANT, ECC,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel.

E. C. CROUTER,
L. C. AARONS,
Special Attorneys, Bureau of Internal Revenue.

Filed T.C.U.S. February 14, 1949.

Served March 1, 1949.

The Tax Court of the United States
Docket No. 18397

PAULINE LINDSEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90:LHP) dated February 19, 1948, and as a basis of this proceeding alleges as follows:

I.

Petitioner is an individual residing at 1203 West Seventh Street, Los Angeles 14, California. Petitioner's income tax return for the period here involved was filed with the Collector of Internal Revenue for the Sixth District of California.

II.

The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A," was mailed to petitioner on February 19, 1948.

III.

The taxes in controversy are federal income taxes for the calendar years 1944 and 1945, as follows:

1944	$2,041.07
1945	2,867.32
Total	$4,908.39

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(1) The respondent erroneously computed the tax upon $4,400.00 representing petitioner's community one-half of $8,800.00 compensation for personal services paid to her husband and attributable to the years 1938 and 1939, upon the basis of including all of said sum in petitioner's 1944 income and taxing said entire amount at the rates applicable for the year 1944 rather than at the rates applicable for the years 1938 and 1939.

(2) Respondent erroneously failed and refused to compute the tax upon said $4,400.00 income at the rates applicable for the years 1938 and 1939, to which years said income was attributable.

(3) The respondent erroneously determined that the provisions of Section 107 of the Internal Revenue Code are not applicable in the computation of

petitioner's tax for the calendar year 1944 and erroneously failed and refused to apply said section in making such computation.

(4) The respondent erroneously computed the tax upon $5,750.00, representing petitioner's community one-half of $11,500.00 compensation for personal services paid to petitioner's husband and attributable to the years 1939 and 1940, upon the basis of including all of said sum in petitioner's 1945 income and taxing said entire amount at the rates applicable for the year 1945 rather than at the rates applicable for the years 1939 and 1940.

(5) Respondent erroneously failed and refused to compute the tax upon said $5,750.00 of income at the rates applicable for the years 1939 and 1940, to which years said income was attributable.

(6) The respondent erroneously determined that the provisions of Section 107 of the Internal Revenue Code are not applicable in the computation of petitioner's tax for the calendar year 1945 and erroneously failed and refused to apply said section in making such computation.

V.

The facts upon which petitioner relies as a basis for this proceeding are as follows:

(1) During the years 1937 through 1945, and up to and including the present date, petitioner's husband has been an officer of the Commodore Hotel Co., Ltd., 1203 West Seventh Street, Los Angeles, California. Said corporation keeps its books and files its income tax returns on the cash receipts and disbursements basis.

(2) By appropriate action of its board of directors evidenced by proper corporate resolution, Commodore Hotel Co., Ltd., undertook and agreed to pay to petitioner's husband monthly from and after January 1, 1937, a salary of $600.00 per month, said salary to continue monthly without interruption.

(3) During each of the years 1938, 1939 and 1940, said corporation suffered deficits from its operations and its capital was impaired. It owed substantial amounts to outside creditors. Because of its straitened circumstances it was unable, during each of said years, to pay to petitioner's husband the full amount of salary which it had been authorized by its board of directors to pay, and which it had agreed to pay. The corporation, however, at all times recognized its liability for the full amount authorized to be paid to petitioner's husband.

(4) During the year 1944 said corporation first found itself in a financial position which would permit it to pay to petitioner's husband a portion of the back salary theretofore unpaid. During said year it actually paid to petitioner's husband the sum of $8,800.00 on account of said back salary, which amount was attributable to the discharge, to the extent possible, of the unpaid salary of petitioner's husband for the years 1938 and 1939.

(5) In preparing their federal income tax returns for the calendar year 1944 petitioner and her husband reported as community property the receipt of said $8,800.00 and computed the tax thereon

in accordance with the provisions of Section 107(d) of the Internal Revenue Code. The respondent has refused to permit the application of said section of the Internal Revenue Code in the computation of petitioner's tax for said year.

(6) During the year 1945 said corporation paid to petitioner's husband the sum of $11,500.00 on account of said back salary, which amount was attributable to the discharge, to the extent possible, of petitioner's husband's unpaid salary for the years 1939 and 1940.

(7) In preparing their federal income tax returns for the calendar year 1945 petitioner and her husband reported as community property the receipt of said $11,500.00 and computed the tax thereon in accordance with the provisions of Section 107(d) of the Internal Revenue Code. The respondent has refused to permit the application of said section of the Internal Revenue Code in the computation of petitioner's tax for said year.

Wherefore, petitioner prays that this court may hear this proceeding and determine:

(1) That respondent erred in the particulars set forth in paragraph IV of this petition.

Respectfully submitted,

/s/ DANA LATHAM,

/s/ AUSTIN H. PECK, JR.,

/s/ HENRY C. DIEHL,

Counsel for Petitioner.

May 6, 1948.

State of California,
County of Los Angeles—ss.

Pauline Lindsey, being first duly sworn, deposes and says: That she is the petitioner in the foregoing petition; that she has read said petition and is familiar with the facts contained therein, and that said facts are true and correct to the best of her knowledge and belief.

/s/ PAULINE LINDSEY.

Subscribed and sworn to before me this 6th day of May, 1948.

[Seal] /s/ ISOBEL V. HUGHES,
Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires Nov. 4, 1948.

EXHIBIT A

Form 1279 (Rev. Mar., 1946) SN-IT-7

Treasury Department
Internal Revenue Service
417 South Hill Street
Los Angeles 13, California

Internal Revenue
Agent in Charge
Los Angeles Division
LA:IT:90D:LHP

Feb. 19, 1948.

Mrs. Pauline Lindsey,
1203 West 7th Street,
Los Angeles 14, California

Dear Mrs. Lindsey:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1944 and 1945, discloses a deficiency of $4,908.39, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los

Angeles, California, for the attention of LA: Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,
GEO. J. SCHOENEMAN,
Commissioner.

By GEORGE D. MARTIN,
Internal Revenue Agent in
Charge.

Enclosures:
Statement
Form of waiver

Statement

LA:IT:90:LHP

Mrs. Pauline Lindsey,
1203 West 7th Street,
Los Angeles 14, California

Tax Liability for the Taxable Years Ended December 31, 1944 and 1945

Years	Deficiency
1944 Income Tax	$2,041.07
1945 Income Tax	2,867.32
Total	$4,908.39

In making this determination of your income tax

liability careful consideration has been given to the report of examination dated March 17, 1947.

Adjustment to Net Income
Taxable Year Ended December 31, 1944

Net income as disclosed by return	$21,841.76
Additional deduction:	
(a) Standard deduction	250.00
Net income adjusted	$21,591.76

Explanation of Adjustment

(a) In your return you elect to take the standard deduction provided in section 23(aa)(1) of the Internal Revenue Code, but claim only $250.00 of the $500.00 allowable. An additional deduction of $250.00 is accordingly allowed.

In your return you disclose receipt in 1944 of compensation for personal services in the amount of $4,400.00 (your community half of $8,800.00) attributable to the years 1938 and 1939 which you include in gross income. However, in the computation of your tax this income is excluded and the tax attributable to such income, computed at the lower rates in effect for such prior years, is added to the amount computed without regard to such income, the total of which is reported as your income tax liability for 1944.

It has been determined that the provisions of section 107 of the Internal Revenue Code are not applicable, and that the aforementioned $4,400.00 constitutes income taxable at the rates in effect in the year received.

Computation of Alternative Tax
Taxable Year Ended December 31, 1944

Net income adjusted		$21,591.76
Less: Excess of net long-term capital gain over net short-term capital loss		1,550.09
Ordinary net income		$20,041.67
Less: Surtax exemption		500.00
Balance (surtax net income)		$19,541.67
Surtax on $19,541.67		7,017.09
Ordinary net income	$20,041.67	
Less: Normal tax exemption	500.00	
Balance subject to normal tax	$19,541.67	
Normal tax (3 per cent of $19,541.67)		586.25
Partial tax		$ 7,603.34
Plus: 50 per cent of $1,550.09		775.04
Alternative tax		$ 8,378.38

Computation of Tax
Taxable Year Ended December 31, 1944

Net income adjusted	$21,591.76	
Less: Surtax exemption	500.00	
Surtax net income	$21,091.76	
Surtax		$ 7,871.39
Net income adjusted	$21,591.76	
Less: Normal-tax exemption	500.00	
Net income subject to normal tax	$21,091.76	
Normal tax at 3%		632.75
Total normal tax and surtax		$ 8,504.14
Alternative tax		$ 8,378.38
Correct income tax liability		$ 8,378.38
Income tax liability shown on return, account No. 9020900		6,337.31
Deficiency of income tax		$ 2,041.07

Net Income
Taxable Year Ended December 31, 1945

The net income of $25,746.91 disclosed in your return is accepted as correct.

In your return you disclose receipt in 1945 of compensation for personal services in the amount of $5,750.00 (your community half of $11,500.00) attributable to the years 1939 and 1940. In the computation of your tax this income is excluded and the tax attributable to such income, computed at the lower rates in effect for such prior years, is added to the amount computed without regard to such income, the total of which is reported as your income tax liability for 1945.

It has been determined that the provisions of section 107 of the Internal Revenue Code are not applicable, and that the aforementioned $5,750.00 constitutes income taxable at the rates in effect in the year received.

Computation of Alternative Tax
Taxable Year Ended December 31, 1945

Net income		$25,746.91
Less: Excess of net long-term capital gain over net short-term capital loss		4,610.63
Ordinary net income		$21,136.28
Less: Surtax exemption		500.00
Balance (surtax net income)		$20,636.28
Surtax on $20,636.28		$ 7,616.32
Ordinary net income	$21,136.28	
Less: Normal tax exemption	500.00	
Balance subject to normal tax	$20,636.28	
Normal tax (3 per cent of $20,636.28)		619.09
Partial tax		$ 8,235.41
Plus: 50 per cent of $4,610.63		2,305.31
Alternative tax		$10,540.72

Computation of Tax
Taxable Year Ended December 31, 1945

Net income	$25,746.91	
Less: Surtax exemption	500.00	
Surtax net income	$25,246.91	
Surtax		$10,295.68
Net income	$25,746.91	
Less: Normal-tax exemption	500.00	
Net income subject to normal tax	$25,246.91	
Normal tax at 3%		757.41
Total normal tax and surtax		$11,053.09
Alternative tax		$10,540.72
Correct income tax liability		$10,540.72
Income tax liability shown on return, account No. 2381798		7,673.40
Deficiency of income tax		$ 2,867.32

Received and Filed T.C.U.S. May 11, 1948.

Served May 12, 1948.

Docket No. 18397

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I and II.

Admits the allegations contained in paragraphs I and II of the petition.

III.

Admits that the taxes in controversy are Federal income taxes for the calendar years 1944 and 1945; denies the remainder of the allegations contained in paragraph III of the petition.

IV.

(1) to (6), inclusive. Denies the allegations of error contained in subparagraphs (1) to (6), inclusive, of paragraph IV of the petition.

V.

(1) For lack of sufficient information as to the truth or correctness thereof denies the allegations contained in subparagraph (1) of paragraph V of the petition.

(2) and (3) Denies the allegations contained in subparagraphs (2) and (3) of paragraph V of the petition.

(4) Admits that during the year 1944 said corporation paid to petitioner's husband the sum of $8,800.00; denies the remainder of the allegations contained in subparagraph (4) of paragraph V of the petition.

(5) Admits that in preparing their Federal income tax returns for the calendar year 1944 petitioner and her husband reported as community property the receipt of said $8,800. Further admits that respondent has held Section 107(d) of the Internal Revenue Code inapplicable in the computation of petitioner's tax for said year. Denies the remainder of the allegations contained in subparagraph (5) of paragraph V of the petition.

(6) Admits that during the year 1945 said corporation paid to petitioner's husband the sum of $11,500; denies the remainder of the allegations contained in subparagraph (6) of paragraph V of the petition.

(7) Admits that in preparing their Federal income tax returns for the calendar year 1945, petitioner and her husband reported as community property the receipt of said $11,500. Further admits that respondent has held Section 107(d) of the Internal Revenue Code inapplicable in the computation of petitioner's tax for said year. Denies the remainder of the allegations contained in subparagraph (7) of paragraph V of the petition.

VI.

Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES OLIPHANT, ECC.
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

E. C. CROUTER,
A. J. HURLEY,
Special Attorneys, Bureau of
Internal Revenue.

Received and Filed T.C.U.S., June 22, 1948.

Docket No. 18397

[Title of Tax Court and Cause.]

AMENDED PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:LHP) dated February 19, 1948, and as a basis of this proceeding alleges as follows:

I.

Petitioner is an individual residing at 1203 West Seventh Street, Los Angeles 14, California. Petitioner's income tax return for the period here involved was filed with the Collector of Internal Revenue for the Sixth District of California.

II.

The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A," was mailed to petitioner on February 19, 1948.

III.

The taxes in controversy are federal income taxes for the calendar years 1944 and 1945, as follows:

1944	$2,041.07
1945	2,867.32
Total	$4,908.39

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(1) The respondent erroneously computed the tax upon $5,000.00 representing petitioner's community one-half of $10,000.00 compensation for personal services paid to her husband and attributable to the years 1937, 1938, and 1939, upon the basis of including all of said sum in petitioner's 1944 income and taxing said entire amount at the rates applicable for the year 1944 rather than at the rates applicable for the years 1937, 1938, and 1939.

(2) Respondent erroneously failed and refused to compute the tax upon said $5,000.00 income at the rates applicable for the years 1937, 1938, and 1939, to which years said income was attributable.

(3) The respondent erroneously determined that the provisions of Section 107 of the Internal Revenue Code are not applicable in the computation of petitioner's tax for the calendar year 1944 and

erroneously failed and refused to apply said section in making such computation.

(4) The respondent erroneously computed the tax upon $5,750.00, representing petitioner's community one-half of $11,500.00 compensation for personal services paid to petitioner's husband and attributable to the years 1939 and 1940, upon the basis of including all of said sum in petitioner's 1945 income and taxing said entire amount at the rates applicable for the year 1945 rather than at the rates applicable for the years 1939 and 1940.

(5) Respondent erroneously failed and refused to compute the tax upon said $5,750.00 of income at the rates applicable for the years 1939 and 1940, to which years said income was attributable.

(6) The respondent erroneously determined that the provisions of Section 107 of the Internal Revenue Code are not applicable in the computation of petitioner's tax for the calendar year 1945 and erroneously failed and refused to apply said section in making such computation.

(7) The respondent erred in failing and refusing to determine that petitioner has overpaid her income taxes for the calendar year 1944.

V.

The facts upon which petitioner relies as a basis for this proceeding are as follows:

(1) During the years 1937 through 1945, and up to and including the present date, petitioner's husband has been an officer of the Commodore Hotel Co., Ltd., 1203 West Seventh Street, Los Angeles,

California. Said corporation keeps its books and files its income tax returns on the cash receipts and disbursements basis.

(2) By appropriate action of its board of directors evidenced by proper corporate resolution, Commodore Hotel Co., Ltd., undertook and agreed to pay to petitioner's husband monthly from and after January 1, 1937, a salary of $600.00 per month, said salary to continue monthly without interruption.

(3) During each of the years 1937, 1938, 1939, and 1940, said corporation suffered deficits from its operations and its capital was impaired. It owed substantial amounts to outside creditors. Because of its straitened circumstances it was unable, during each of said years, to pay to petitioner's husband the full amount of salary which it had been authorized by its board of directors to pay, and which it had agreed to pay. The corporation, however, at all times recognized its liability for the full amount authorized to be paid to petitioner's husband.

(4) During the year 1944 said corporation first found itself in a financial position which would permit it to pay to petitioner's husband a portion of the back salary theretofore unpaid. During said year it actually paid to petitioner's husband the sum of $10,000.00 on account of said back salary, which amount was attributable to the discharge, to the extent possible, of the unpaid salary of petitioner's husband for the years 1937, 1938, and 1939.

(5) In preparing their federal income tax returns for the calendar year 1944 petitioner and her

husband reported as community property the receipt of said $10,000.00 and computed the tax thereon in accordance with the provisions of Section 107(d) of the Internal Revenue Code. The respondent has refused to permit the application of said section of the Internal Revenue Code in the computation of petitioner's tax for said year.

(6) During the year 1945 said corporation paid to petitioner's husband the sum of $11,500.00 on account of said back salary, which amount was attributable to the discharge, to the extent possible, of petitioner's husband's unpaid salary for the years 1939 and 1940.

(7) In preparing their federal income tax returns for the calendar year 1945 petitioner and her husband reported as community property the receipt of said $11,500.00 and computed the tax thereon in accordance with the provisions of Section 107(d) of the Internal Revenue Code. The respondent has refused to permit the application of said section of the Internal Revenue Code in the computation of petitioner's tax for said year.

(8) Petitioner's income tax return for the calendar year 1944 disclosed a liability for taxes in the amount of $6,337.31, which amount was paid on or before March 15, 1945. Petitioner's correct tax liability for said year 1944 is $5,607.42. Petitioner has overpaid her 1944 income taxes in the amount of $729.84, and refund of said amount is hereby claimed.

Wherefore, petitioner prays that this court may hear this proceeding and determine:

(1) That respondent erred in the particulars set forth in paragraph IV of this petition.

Respectfully submitted,

/s/ DANA LATHAM,
/s/ AUSTIN H. PECK, JR.,
/s/ HENRY C. DIEHL,
Counsel for Petitioner.

January 25, 1949.

State of California,
County of Los Angeles—ss.

Pauline Lindsey, being first duly sworn, deposes and says: That she is the petitioner in the foregoing petition; that she has read said petition and is familiar with the facts contained therein, and that said facts are true and correct to the best of her knowledge and belief.

/s/ PAULINE I. LINDSEY.

Subscribed and sworn to before me this 7th day of February, 1949.

[Seal] /s/ LILLIAN S. FOLTZ,
Notary Public in and for the County of Los Angeles, State of California.

EXHIBIT A

[Exhibit A is identical to Exhibit A attached to the Petition (Docket No. 18397) and is set out at pages 8 and 9 of this printed record.]

Filed T.C.U.S. February 9, 1949.
Served March 1, 1949.

[Title of Tax Court and Cause.]

ANSWER TO AMENDED PETITION

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, for answer to the amended petition of the above-named taxpayer, admits and denies as follows:

I and II.

Admits the allegations contained in paragraphs I and II of the amended petition.

III.

Admits that the taxes in controversy are Federal income taxes for the calendar years 1944 and 1945. Denies the remainder of the allegations contained in paragraph III of the amended petition.

IV.

(1) to (7), inclusive. Denies the allegations of error contained in subparagraphs (1) to (7), inclusive, of paragraph IV of the amended petition.

V.

(1) Admits the allegations contained in subparagraph (1) of paragraph V of the amended petition.

(2) Admits that on April 14, 1937, the board of directors of Commodore Hotel Co., Ltd., authorized the payment of salary to petitioner's husband in the amount of $600.00 per month commencing as of January 1, 1937. Denies the remainder of the alle-

gations contained in subparagraph (2) of paragraph V of the amended petition.

(3) Admits that during each of the years 1937, 1938, 1939 and 1940, said corporation suffered deficits from operations and in its capital account. Denies the remainder of the allegations contained in subparagraph (3) of paragraph V of the amended petition.

(4) Admits that during the year 1944 said corporation paid to petitioner's husband the sum of $10,000.00. Denies the remainder of the allegations contained in subparagraph (4) of paragraph V of the amended petition.

(5) Admits that in preparing their Federal income tax returns for the calendar year 1944 petitioner and her husband reported as community property the receipt of said $10,000.00; further admits that respondent has held Section 107(d) of the Internal Revenue Code inapplicable in the computation of petitioner's tax for said year. Denies the remainder of the allegations contained in subparagraph (5) of paragraph V of the amended petition.

(6) Admits that during the year 1945 said corporation paid to petitioner's husband the sum of $11,500.00. Denies the remainder of the allegations contained in subparagraph (6) of paragraph V of the amended petition.

(7) Admits that in preparing their Federal income tax returns for the calendar year 1945 petitioner and her husband reported as community

property the receipt of said $11,500.00; further admits that respondent has held Section 107(d) of the Internal Revenue Code inapplicable in the computation of petitioner's tax for said year. Denies the remainder of the allegations contained in subparagraph (7) of paragraph V of the amended petition.

(8) Admits that the amount of liability for taxes shown by petitioner on her income tax return for the calendar year 1944 was $6,337.31. Denies the remainder of the allegations contained in subparagraph (8) of paragraph V of the amended petition.

VI.

Denies each and every allegation contained in the amended petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES OLIPHANT, ECC
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel;

E. C. CROUTER,

L. C. AARONS,
Special Attorneys,
Bureau of Internal Revenue.

Filed T.C.U.S. February 14, 1949.

Served March 1, 1949.

The Tax Court of the United States

Docket Nos. 16756, 16757, 18396 and 18397

Promulgated January 12, 1951

ESTATE OF R. L. LANGER, Deceased; ELEANORE LANGER, Executrix,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ELEANORE LANGER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

C. ABBOTT LINDSEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PAULINE LINDSEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

FINDINGS OF FACT AND OPINION

On remand from the United States Court of Appeals for the Ninth Circuit, held:

(1) Back pay of $10,000 received by decedent R. L. Langer in 1944, and of $10,000 and $11,500 received by petitioner C. Abbott Lindsey in 1944 and 1945, respectively, was paid pursuant to prior agreement and legal obligation within the meaning of Regulations 111, section 29.107-3.

(2) Above back pay of $10,000 received by decedent R. L. Langer constituted more than 15 per cent of the gross income of R. L. Langer and Eleanore Langer in 1944, and petitioners' Estate of R. L. Langer, Deceased; Eleanore Langer, Executrix, and Eleanore Langer are entitled to the benefits of section 107(d), Internal Revenue Code, with respect thereto.

(3) Above back pay of $10,000 and $11,500 received by petitioner C. Abbott Lindsey constituted less than 15 per cent of the gross income of petitioners C. Abbott Lindsey and Pauline Lindsey in 1944 and 1945, respectively, and they are not entitled to the benefits of section 107(d), Internal Revenue Code, with respect thereto.

AUSTIN H. PECK, JR., ESQ.,
For the Petitioners.

L. C. AARONS, ESQ.,
For the Respondent.

These proceedings return to us by mandate of the United States Court of Appeals for the Ninth Circuit, issued under its opinion of July 14, 1950, 183 Fed. (2d) 758, reversing our prior decision of September 29, 1949, in these proceedings (Findings of Fact and Opinion reported at 13 T.C. 419). The mandate directs:

> It is now here ordered and adjudged by this court, that the decision of the said Tax Court of the United States in each of these causes be, and hereby is reversed, and that these causes be, and hereby are remanded to the said Tax Court with directions to proceed in accord with the opinion of this court, and to dispose of other issues presented on the record.

We therefore proceed as directed by the mandate. In addition to the facts heretofore found, which by reference are adopted here, we find on the same record as follows:

Findings of Fact

The net rentals from the Clifton Hotel were apportioned on Schedule B of the 1944 returns of R. L. Langer and Eleanore Langer as follows:

Net Rentals			$14,498.01
Apportionment among owners:			
R. L. & Eleanore Langer	½	$7,249.00	
Nelda Clinton	⅜	5,436.75	
Mary R. Brown	⅛	1,812.26	$14.498.01

The net profits from the Figueroa Hotel were

apportioned on Schedule C of the Langers' 1944 returns as follows:

Net Profit		$59,441.42
Clifford Clinton	$21,165.53	
R. M. Callicott	7,055.18	
	$28,220.71	
R. L. & Eleanore Langer	31,220.71	$59,441.42

This represents a distribution of 3/8 of the net profits from the Figueroa Hotel to Clifford Clinton, 1/8 to R. M. Callicott, and 1/2 to the Langers, with $3,000 additional, or $250 per month, being distributed to the Langers as administration expense, in accordance with a joint venture agreement between R. L. Langer, Clifford Clinton and R. M. Callicott, evidenced by the following memorandum executed September 22, 1945:

Memorandum of Agreement

This memorandum, executed September 22nd, 1945, by R. L. Langer, Clifford E. Clinton and Ransom M. Callicott, of Los Angeles, California, evidences and confirms the terms of a financing and profit-sharing agreement in the nature of a limited joint venture entered into between them before execution of the lease hereinafter mentioned and ever since effective, as follows:

1. Upon the consideration and agreement herein expressed the parties joined in providing and contributing the moneys paid by said Langer in acquiring said lease and commencing operations

thereunder; which lease dated June 1, 1945, (and recorded in Book 13415, pp. 270-279, of Official Records of Los Angeles County, Cal.) was made by Figueroa Hotel Company, as lessor, to said Langer, as lessee, affecting, for ten years then beginning, the property and furnishings thereof known as "Figueroa Hotel," at Figueroa Street and Olympic Boulevard in said City of Los Angeles, and was extended by agreement between said parties thereto, dated July 21, 1939, for an additional term ending May 31, 1949.

2. Upon such consideration it was and is so agreed the parties shall be entitled to and that there shall be shared between them in the proportions of:

Langer.....one-half,
Clinton.....three-eighths, and
Callicott.....one-eighth,

all net profits and losses accruing from operation of said property while under such lease and extension or any further such extension or lease to him, or which he shall be instrumental in obtaining as to said property for any member of his family or corporation in which he or they shall be interested, or resulting from any sale or disposition of any such leasehold (this agreement to continue in effect so long as any such lease or leasehold shall be in effect); and that said other parties shall be entitled, though not required, to participate, in the proportions aforesaid, with said Langer or any such lessee in any opportunity to him or such lessee to pur-

chase said property during or at expiration of any such leasehold.

Such net profit from operation of said property shall include all gross receipts and revenue accruing and received therefrom, after deduction of only current expenses of such operation, including rental and other charges payable under such then lease; provided while Langer shall hereafter personally continue management of such operation he may deduct and retain from such profit for each month, before division thereof and in like manner as an expense of such operation, $350.00 (the similar deduction of $250.00 per month for approximately three years next prior hereto being approved).

Accounting and settlement in accordance herewith has been made as to such net profit for the period ending September 22, 1945, and shall be final save for errors. Further such accounting and payment shall be made monthly. Langer shall keep and maintain at a convenient place at Los Angeles full and complete books, accounts and records of such operation and profit, and the same shall be open to inspection of the other parties and their representatives at all reasonable times with the right to make extracts or copies.

3. Langer shall endeavor to procure extensions of such existing leasehold or further leases of said property as possible from time to time so that this agreement may continue effective as aforesaid. He shall promptly notify the other parties in advance of each such further extension or new lease and proposals therefor. So far as possible each thereof

shall be made only on terms first approved in writing by the other parties hereto; but should that be impossible Langer may nevertheless make the same on other terms, subject to the right of the other parties at their election to terminate this agreement effective at commencement of the term of any such lease or extension on terms not so approved by them.

4. During continuance hereof Langer and his successors shall not, without the other parties' written consent, transfer, assign or hypothecate the then leasehold interest in such property or consent to modification or termination thereof, or sublet the property other than as incident to usual hotel operation, and shall promptly discharge the obligations of such leasehold and continue operation of said property in the same general manner as heretofore but shall not incur any unusual expense which might affect such profits without written consent of the parties.

5. Under and pursuant to such agreement, the subject matter thereof, and the respective rights and interests of the parties thereunder were and are only such as shall be consistent with and not in violation, or constituting in creation thereof, any violation of said lease.

The respective interests of the parties hereunder are assignable and shall be unaffected by death of any of them; and the same and this agreement and its obligations shall inure to the benefit of and bind the parties, their heirs, successors and assigns in

accordance with the terms thereof and as if parties hereto in the capacity of the party through whom claiming.

In Witness Whereof, they execute this instrument on the date aforesaid.

[Signed] R. L. LANGER,

[Signed] CLIFFORD E. CLINTON,

[Signed] RANSOM M. CALLICOTT.

The Clifton Hotel was operated as a joint venture in 1944 by the Langers in conjunction with Nelda Clinton and Mary R. Brown. The Figueroa Hotel was operated as a joint venture in 1944 by the Langers in conjunction with Clifford Clinton and R. M. Callicott. The Langers' distributive share of the net profits in that year from such joint ventures was $7,249, or $3,624.50 apiece, from the Clifton Hotel, and $31,220.71, or $15,610.35 apiece, from the Figueroa Hotel.

The back pay of $10,000 received by R. L. Langer in 1944 from the Commodore Hotel Company, allocable $5,000 to R. L. Langer and $5,000 to Eleanore Langer, comprised more than 15 per cent of their respective gross incomes of $30,729.45 and $31,854.43.

The gross income reported by the Lindseys in 1944 was $44,183.52, or $22,091.76 apiece. Their gross income for 1944 was actually $101,569.40, or $50,784.70 apiece, computed to include "other business deductions" of the Commodore Cafe, amounting to $57,385.88. The back pay of $10,000

received by C. Abbott Lindsey in 1944 from the Commodore Hotel Company, allocable $5,000 to Lindsey and $5,000 to Pauline Lindsey, comprised less than 15 per cent of such gross incomes.

In 1945 the total receipts of the Commodore Cafe, as reported by the Lindseys, were $144,897.99, cost of goods sold $58,911.83, other business deductions $65,564.72. The gross income reported by the Lindseys in 1945 was $52,493.82, or $26,246.91 apiece. Their gross income for 1945 was actually $118,058.54, or $59,029.27 apiece, computed to include "other business deductions" of the Commodore Cafe, amounting to $65,564.72. The back pay of $11,500 received by C. Abbott Lindsey in 1945 from the Commodore Hotel Company, allocable $5,750 to Lindsey and $5,750 to Pauline Lindsey, comprised less than 15 per cent of such gross incomes.

Opinion

Johnson, Judge:

The Court of Appeals for the Ninth Circuit determined in Estate of R. L. Langer v. Commissioner, 183 Fed. (2d) 758; reversing 13 T.C. 419, that the deferment in payment of the amounts of back salary here in question was caused by an event similar to receivership within the requirement of section 107(d)(2)(A), Internal Revenue Code, contrary to the contention of respondent and to our prior holding. Respondent, however, also contends that section 107(d) is not applicable because the employer was under no obligation to pay in prior years, and because the payments were less than 15 per cent of

petitioners' gross incomes, which he says should be computed to comprise receipts undiminished by the expenses of businesses from which they derived income. Pursuant to mandate we now consider these contentions, which we found it unnecessary to consider under our prior holding.

Respondent points out that under Regulations 111, section 29.107-3, "back pay" does not include "additional compensation for past services when there was no prior agreement or legal obligation to pay such additional compensation * * *." He maintains that except as to part of the year 1937, petitioners' salaries were authorized retroactively by the board of directors of the Commodore Hotel Company on January 3, 1944, that there was no prior agreement or legal obligation to pay such salaries, and that the resolution of the board of directors of April 14, 1937, that salaries of $600 a month be paid Langer and Lindsey from January 1, 1937, and "every month hereafter" was intended for one year only. Petitioners maintain that the 1937 authorization was a continuing one and extended beyond the year.

We think the facts clearly support petitioners on this issue. The salaries were voted in 1937 and we do not understand the resolution to cover only 1937, especially in view of the phrase "every month hereafter." But whatever period the resolution covered, the presumption is that petitioners' services after 1937 were not gratuitous and that the parties intended the same compensation. As said in 6A Cal. Jur. 1125:

> If an officer is hired at a fixed salary and continues in the same employment after expiration of the term of his original hiring without a new contract, it is presumed that the parties intend the same compensation.

See also, Fletcher, Cyclopedia of Corporations, Vol. 16, pp. 440-41; Caminetti v. Prudence Mut. Life Ins. Assn., 62 Cal. App. (2d) 945, 146 Pac. (2d) 15; Perry v. J. Noonan Furniture Co., 8 Cal. App. 35, 95 Pac. 1128. The facts show that the Commodore Hotel Company failed to pay salaries from 1937 to 1942 because it was not able to do so, not because it was not liable to do so. The 1944 authorization recognized that there were owing to the officers specific amounts of back salary for 1937, 1938, 1939, 1940, 1941, and 1942. In other words, the 1944 authorization was not a retroactive authorization but a recognition of a liability that already existed, and it merely directed the satisfaction of that liability as soon as possible. The fact that the corporation paid the back salaries without approval of the Salary Stabilization Unit of the Treasury after being informed by the latter that it could do so without approval only if "there was a bona fide contractual liability on October 3, 1942," also supports our conclusion that such a liability existed. We can not assume that the corporation violated the law.

Respondent also contends that petitioners have failed to meet the requirement of section 107(d) that in order for a taxpayer to be entitled to the benefits of that section, the amount of back pay

received or accrued during the taxable year must exceed 15 per cent of the taxpayer's gross income for that year. Petitioners contend that only the net profits derived from the operation of the Commodore Cafe in 1944 and 1945, i.e., gross receipts less cost of goods sold and other business deductions, are includible in the gross incomes of the Lindseys in 1944 and 1945 for purposes of section 107(d). They concede that "if gross receipts are to be used in determining the percentage under section 107(d), the Lindseys are not entitled to the relief which they have claimed. Likewise, if gross sales, less cost of goods sold, is the correct figure, the relief is lost." In effect, they are claiming that the adjusted gross incomes of the Lindseys in 1944 and 1945, which include only net profits from business, should be the figures upon which the 15 per cent should be computed for purposes of section 107(d).

We disagree. The statute plainly says "gross income," not "adjusted gross income." Whenever Congress has intended a percentage to apply to "adjusted gross income," it has said so, as in the allowance for charitable contributions under section 23(o), or for medical expenses under section 23(x). Similarly, when it has intended a percentage to apply to "gross income," as in section 275(c), it has also said so. We can not therefore impute an intention on the part of Congress to refer to "adjusted gross income" in section 107(d) when it has plainly said "gross income."

In defining "gross income from business," section 29.22(a)-5 of Regulations 111, provides:

> In the case of a manufacturing, merchandis-

> ing, or mining business, "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses, or losses, or for items not ordinarily used in computing the cost of goods sold.[1] * * *

The back pay received by Lindsey of $10,000 in 1944 and $11,500 in 1945, allocable half to his wife, not being more than 15 per cent of the gross incomes of the Lindseys of $101,569.40, or $50,784.70 apiece, in 1944, and $118,058.54, or $59,029.27 apiece, in 1945, computed to include gross receipts from the Commodore Cafe less cost of goods sold, they are not entitled to the relief of section 107(d).

As for the Langers, the other petitioners herein, the facts show that they reported income in 1944 from the operation of the Clifton Hotel and the Figueroa Hotel. In each hotel the interest of the Langers was 50 per cent. The other owners of the Clifton Hotel were Nelda Clinton, who owned 37½ per cent, and Mary R. Brown, who owned 12½ per cent. The other owners of the Figueroa Hotel were Clifford E. Clinton, who owned 37½ per cent, and R. N. Callicott, who owned 12½ per cent. The Langers reported on the schedules of their 1944 returns the gross receipts from these two hotels,

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[1]This fundamental concept of "gross income" from business as gross receipts less cost of goods sold has stood unchallenged for many years. See Mim. 2915 and I.T. 1241, I-1 C.B. 233, 234.

but they brought forward to the face of the returns only their 50 per cent share of the net profits from each hotel, i.e., gross receipts less business expenses less the 50 per cent share of the net profits apportioned to the other owners. Petitioners contend that only this net amount is includible in the Langers' gross income for purposes of section 107(d). They maintain that these two hotels were operated by the Langers and the co-owners as joint ventures. They point out that if the joint ventures had filed partnership returns as they should have,[2] the business expenses of the joint ventures would have been deducted on the partnership returns and only the Langers' distributive share of the net profits from these ventures would have been reported on their individual returns.

Respondent does not question the division of the income from these hotels between the Langers and their co-owners, and he concedes that if partnership returns had been filed, he would not question the

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[2]Sec. 3797. Definitions.

Internal Revenue Code.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * *

(2) Partnership and Partner.—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

Langers' inclusion of only their share of the net porfits from such ventures in their individual gross incomes for purposes of section 107(d). But he maintains that in view of the failure to file partnership returns petitioners can not now contend that these were joint ventures and compute the Langers' individual gross incomes as though partnership returns had been filed.

We do not agree. The determination of whether or not an undertaking is a joint venture or partnership does not depend on whether or not a partnership return was filed, and respondent gives no other reason for challenging the existence of these joint ventures. We have found on the facts that joint ventures did exist between the Langers and their co-owners in the operation of the Figueroa and Clifton Hotels in 1944. Accordingly, partnership returns should have been filed and the Langers are entitled to include, as they did, in their gross incomes for 1944 only their distributive shares of the net profits of the joint ventures. The $10,000 in back pay received by Langer in 1944, allocable $5,000 to him and $5,000 to his wife, constituted more than 15 per cent of their gross incomes ($30,729.45 for Langer and $31,854.43 for his wife) so computed, and, being otherwise within the provisions of section 107(d), Internal Revenue Code, petitioners Estate of R. L. Langer and Eleanore Langer are entitled to the benefits of that section with respect to that back pay.

Decisions will be entered under Rule 50.

Served January 12, 1951.

The Tax Court of the United States
Washington

Docket No. 18396

C. ABBOTT LINDSEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to mandate of the Court of Appeals for the Ninth Circuit filed August 17, 1950, and Findings of Fact and Opinion of this Court promulgated January 12, 1951, the respondent herein, on March 30, 1951, filed a computation of tax, in which petitioner filed an agreement on March 30, 1951. Now, therefore, it is

Ordered and Decided: That there are deficiencies in income tax for the years 1944 and 1945 in the respective amounts of $2,041.07 and $2,867.32 (assessed and paid).

[Seal] /s/ LUTHER A. JOHNSON,
Judge.

Entered Apr. 3, 1951.

Served Apr. 4, 1951.

The Tax Court of the United States
Washington

Docket No. 18397

PAULINE LINDSEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to mandate of the Court of Appeals for the Ninth Circuit filed August 17, 1950, and Findings of Fact and Opinion of this Court promulgated January 12, 1951, the respondent herein, on March 30, 1951, filed a computation of tax, in which petitioner filed an agreement on March 30, 1951. Now, therefore, it is

Ordered and Decided: That there are deficiencies in income tax for the years 1944 and 1945 in the respective amounts of $2,041.07 and $2,867.32 (assessed and paid).

[Seal] /s/ LUTHER A. JOHNSON,
Judge.

Entered Apr. 3, 1951.

Served Apr. 4, 1951.

In the United States Circuit Court of Appeals
for the Ninth Circuit

Docket No. 12959

C. ABBOTT LINDSEY and PAULINE LINDSEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

C. Abbott Lindsey and Pauline Lindsey, petitioners in the above-entitled cases which were consolidated for trial, hereby petition this Court to review the decision of the Tax Court of the United States heretofore entered in said proceeding on April 3, 1951. Petitioners respectfully represent:

I.

Jurisdiction

This petition is filed pursuant to Internal Revenue Code, Sections 1141 and 1142, 26 U.S.C.A., Sections 1141 and 1142.

II.

Nature of Controversy

The present controversy relates to the proper determination of the federal income tax liability of petitioners C. Abbott Lindsey (Tax Court Docket No. 18396) and Pauline Lindsey (Tax Court Docket No. 18397) for the calendar years 1944 and 1945.

Respondent determined deficiencies in income taxes of petitioners C. Abbott Lindsey and Pauline Lindsey for the calendar years 1944 and 1945 as follows:

C. Abbott Lindsey...	1944	$2,041.07
	1945	2,867.32
Pauline Lindsey.....	1944	2,041.07
	1945	2,867.32

The Tax Court of the United States, by its said decision, sustained respondent's determinations. Petitioners hereby petition for a review of said decision of the Tax Court of the United States.

III.

Venue

Petitioners filed their respective separate federal income tax returns for the calendar years 1944 and 1945 with the Collector of Internal Revenue for the Sixth District of California at Los Angeles, California. Accordingly, petitioners are petitioning for a review of said decision of the Tax Court of the United States by this United States Circuit Court of Appeals for the Ninth Circuit.

Wherefore, your petitioners pray that this Court review said decision of the Tax Court of the United States, reverse the same, and issue such order or orders as may be proper in the premises.

Dated: April 23, 1951.

Respectfully submitted,

/s/ AUSTIN H. PECK, JR.,
Attorney for Petitioners.

State of California,
County of Los Angeles—ss.

Austin H. Peck, Jr., being first duly sworn, on oath deposes and says:

I am the attorney for the petitioners in this proceeding. I have read the foregoing petition and am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information and belief. This petition is not filed for purposes of delay, and I believe that petitioners are justly entitled to the relief sought.

/s/ AUSTIN H. PECK, JR.

Subscribed and sworn to before me this 23rd day of April, 1951.

[Seal] /s/ LILLIAN S. FOLTZ,
Notary Public in and for the County of Los Angeles, State of California.

My commission expires April 28, 1954.

Filed T.C.U.S. May 2, 1951.

[Title of Court of Appeals and Cause.]

NOTICE OF FILING OF PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES

To the Commissioner of Internal Revenue,
Washington, D. C.:

You are hereby notified that petitioners in the above-entitled proceeding in the Tax Court of the United States have filed, concurrently herewith, their petition to the United States Circuit Court of Appeals for the Ninth Circuit for review of the decision of the Tax Court in said proceeding. A copy of said petition for review, together with this notice, are hereby served on you.

Dated: April 23, 1951.

/s/ CHESTER H. PECK, JR.,
Attorney for Petitioners.

Affidavit of Service

District of Columbia—ss.

Helene G. Keawans, being first duly sworn, on oath deposes and says:

That she is a citizen of the United States and a resident of the City of Washington, D. C.; that she is not a party to the within action; and that her business address is 404 Transportation Bldg., Washington, D. C.

That on the 2nd day of May, 1951, she served the Notice of Filing of Petition for Review of Decision

of the Tax Court of the United States and Petition for Review of Decision of the Tax Court of the United States on the respondent by placing a true copy of each in an envelope addressed to the attorney of record for said respondent at the office address of said attorney, as follows: "Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, Washington, D. C."; and by then sealing said envelope and depositing the same with postage thereon fully prepaid, in the United States mail at Washington, D. C.; and that there is delivery service by United States mail at the place so addressed and there is a regular communication by mail between the place of mailing and the place so addressed.

/s/ HELENE G. KEAWANS.

Subscribed and sworn to before me this 2d day of May, 1951.

[Seal] /s/ LUCY L. ALLEN,
Notary Public.

My Commission expires Jan. 31, 1955.

Filed T.C.U.S. May 2, 1951.

[Title of Court of Appeals and Cause.]

DESIGNATION OF CONTENTS OF RECORD ON APPEAL AND STATEMENT OF POINTS

To Victor S. Mersch, Clerk of the Tax Court of the United States, Washington, D. C.:

Petitioners in the above-entitled consolidated pro-

ceedings hereby designate the following portions of the record before the Tax Court of the United States to be contained in the record on review before the United States Circuit Court of Appeals for the Ninth Circuit:

(1) Petition and amended petition of petitioner C. Abbott Lindsey (Docket No. 18396).

(2) Petition and amended petition of petitioner Pauline Lindsey (Docket No. 18397).

(3) Answer to petition and amended petition of petitioner C. Abbott Lindsey (Docket No. 18396).

(4) Answer to petition and amended petition of petitioner Pauline Lindsey (Docket No. 18397).

(5) Findings of fact and opinion of the Tax Court (16 T. C. . . . ., No. 6).

(6) Decisions of the Tax Court entered April 3, 1951.

(7) The petition for review of the decisions of the Tax Court and notice of filing of petition for review, together with proof of service of said petition and said notice.

(8) This designation of contents of record on appeal and statement of points and the notice of filing thereof, together with proof of service of said designation and notice.

Statement of Points on Which Petitioners Intend to Rely

(1) The Tax Court erred in entering decisions for the respondent.

(2) The Tax Court erred in not entering decisions for petitioners and each of them.

(3) The Tax Court erred in failing to find or conclude that there were no deficiencies in income taxes of petitioners or either of them for the calendar years involved.

(4) The Tax Court erred in its conclusion that section 107(d), Internal Revenue Code, 26 U.S.C.A., section 107(d), was not properly invoked by petitioners in the determination of their federal income tax liability for the years here involved.

(5) The Tax Court erred in its conclusion that the "back pay" received by petitioners in 1944 and 1945 did not exceed fifteen per cent of petitioners' gross income for said years, as that term is used in section 107(d), Internal Revenue Code, 26 U.S.C.A., section 107(d).

(6) The Tax Court erred in failing to find or conclude that petitioners C. Abbott Lindsey and Pauline Lindsey have overpaid their federal income taxes for the year 1944.

Dated: April 24, 1951.

Respectfully submitted,

/s/ AUSTIN H. PECK, JR.,
Attorney for Petitioners.

Filed T.C.U.S. May 2, 1951.

[Title of Court of Appeals and Cause.]

NOTICE OF FILING OF DESIGNATION OF CONTENTS OF RECORD ON APPEAL AND STATEMENT OF POINTS

To the Commissioner of Internal Revenue,
Washington, D. C.:

You are hereby notified that petitioners in the above-entitled proceeding in the Tax Court of the United States have filed with the Clerk of the Tax Court petitioners' designation of contents of record on appeal and statement of points. A copy thereof, and of this notice, are hereby served upon you.

Dated: April 23, 1951.

/s/ AUSTIN H. PECK, JR.,
Attorney for Petitioners.

Affidavit of Service

District of Columbia—ss.

Helene G. Keawans, being first duly sworn, on oath deposes and says:

That she is a citizen of the United States and a resident of the City of Washington, D. C.; that she is not a party to the within action; and that her business address is 404 Transportation Bldg., Washington, D. C.

That on the 2nd day of May, 1951, she served the Notice of Filing of Designation of Contents of Record on Appeal and Statement of Points, to which this affidavit is attached, and the Designation

of Contents of Record on Appeal and Statement of Points, on the respondent by placing a true copy of each in an envelope addressed to the attorney of record for said respondent at the office address of said attorney, as follows: "Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, Washington, D. C."; and by then sealing said envelope and depositing the same with postage thereon fully prepaid, in the United States mail at Washington, D. C.; and that there is delivery service by United States mail at the place so addressed and there is a regular communication by mail between the place of mailing and the place so addressed.

/s/ HELENE G. KEAWANS.

Subscribed and sworn to before me this 2nd day of May, 1951.

[Seal] /s/ LUCY L. ALLEN,
Notary Public.

My commission expires Jan. 31, 1955.

Filed T.C.U.S. May 2, 1951.

[Title of Tax Court and Cause.]

CLERK'S CERTIFICATE

I, Victor S. Mersch, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents 1 to 17, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designation of Contents of Record" before the Tax Court of the United States entitled: C. Abbott Lindsey and Pauline Lindsey, Petitioners, v. Commissioner of Internal Revenue, Respondent, Docket Numbers 18396 and 18397, and in which the petitioners in the Tax Court proceeding have initiated an appeal as above numbered and entitled, together with true copies of the docket entries in said Tax Court proceedings as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 29th day of May, 1951.

[Seal] /s/ VICTOR S. MERSCH,
Clerk, the Tax Court of the
United States.

[Endorsed]: No. 12959. United States Court of Appeals for the Ninth Circuit. C. Abbott Lindsey and Pauline Lindsey, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of the Tax Court of the United States.

Filed June 4, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

Nos. 12959, 12970, 12971.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 12959.

C. ABBOTT LINDSEY and PAULINE LINDSEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 12970.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ELEANORE LANGER,

Respondent.

No. 12971.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ESTATE OF R. L. LANGER, Deceased; ELEANORE LANGER, Executrix,

Respondent.

BRIEF FOR PETITIONERS LINDSEY AND RESPONDENT LANGER.

DANA LATHAM,
AUSTIN H. PECK, JR.,
HENRY C. DIEHL,
411 West Fifth Street,
Los Angeles 13, California,

Attorneys for Petitioner in Docket No. 12959, and for Respondents in Docket Nos. 12970 and 12971.

Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 12959.

C. ABBOTT LINDSEY and PAULINE LINDSEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 12970.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ELEANORE LANGER,

Respondent.

No. 12971.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ESTATE OF R. L. LANGER, Deceased; ELEANORE LANGER, Executrix,

Respondent.

BRIEF FOR PETITIONERS LINDSEY AND RESPONDENT LANGER.

Jurisdiction.

These petitions for review involve federal income taxes of C. Abbott Lindsey and Pauline Lindsey, husband and wife, for the calendar years 1944 and 1945, and Eleanore

Langer and the Estate of R. L. Langer, deceased, Eleanore Langer, executrix, for the calendar year 1944.

The Commissioner of Internal Revenue in 1947 and 1948 determined deficiencies in the federal income taxes of each of the taxpayers, and mailed notices of deficiency [R. 8-9, 32, 33, Docket Number 12959; R. 10-11, Docket Number 12970; R. 10-11, Docket Number 12971]. The taxpayers thereafter filed petitions with the The Tax Court of the United States (herein referred to as the "Tax Court") pursuant to the provisions of Section 272 of the Internal Revenue Code (26 U. S. C. A., Sec. 272). The original decisions of the Tax Court were in favor of the Commissioner of Internal Revenue (13 T. C. 419). Following appeal of said decisions to this Court, and reversal thereof and remand to the Tax Court, the decisions of the Tax Court on remand were entered April 3, 1951 [R. 64-65, Docket Number 12959; R. 30, Docket Number 12970; R. 30, Docket Number 12971].

Petition for review was filed by C. Abbott Lindsey and Pauline Lindsey on or about May 2, 1951 [R. 66-68, Docket Number 12959] pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code (26 U. S. C. A., Secs. 1141 and 1142). Petitions for review in the *Langer* cases were filed by the Commissioner of Internal Revenue on or about May 3, 1951 [R. 31-32, Docket Number 12970; R. 31-32, Docket Number 12971] pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code (26 U. S. C. A., Secs. 1141 and 1142).

Previous Opinions.

The following opinions have heretofore been rendered in these causes:

Original opinion of the Tax Court reported at 13 T. C. 419.

The opinion of this Court on appeal from said original decisions of the Tax Court, reported at 183 F. 2d 758.

The opinion of the Tax Court on remand reported at 16 T. C. ....., No. 6 [R. 49-63, Docket Number 12959; R. 15-29, Docket Number 12970; R. 15-29, Docket Number 12971].

Question Presented.

The single question presented for adjudication in these proceedings is whether back pay received by the taxpayers in 1944 and 1945 exceeded 15% of their gross income for said years as that term is used in Section 107(d) of the Internal Revenue Code (26 U. S. C. A., Sec. 107(d)).

Statute and Regulations Involved.

Section 107(d) of the Internal Revenue Code (26 U. S. C. A., Sec. 107(d)), and regulations issued pursuant thereto are set forth in the Appendix, *infra.*

Statement.

During the calendar year 1944 C. Abbott Lindsey, as an officer and employee of Commodore Hotel Co., Ltd., a California corporation (herein referred to as "Commodore"), received back pay of $10,000 from Commodore, allocable $5,000 to C. Abbott Lindsey and $5,000 to

Pauline Lindsey, they having filed separate returns for said year on a community property basis [R. 56-57, Docket Number 12959]. In 1945 Lindsey, as an officer and employee of Commodore, received back pay of $11,500 from Commodore, allocable $5,750 to C. Abbott Lindsey and $5,750 to Pauline Lindsey, they having filed separate returns for said year on a community property basis [R. 57, Docket Number 12959].

During the calendar year 1944, R. L. Langer, as an officer and employee of Commodore, received back pay of $10,000 from Commodore, allocable $5,000 to R. L. Langer and $5,000 to Eleanore Langer, they having filed separate returns on a community property basis for said year [R. 22, Docket Number 12970; R. 22, Docket Number 12971]. (The Langers also received back pay in 1945, but said year is not before the Court.)

Both the Langers and the Lindseys computed their tax liabilities for the years involved under the provisions of Section 107(d) of the Internal Revenue Code. In so doing they applied to the back pay the rates of tax applicable for the years to which said back pay was allocable. The Commissioner of Internal Revenue audited the Langer returns for the year 1944 and the Lindsey returns for the years 1944 and 1945 and determined that none of them were entitled to apply Section 107(d), stating as reasons therefor that:

> (1) Commodore's failure to pay the salaries during the prior years was not attributable to the existence of a condition similar to bankruptcy or receivership;
>
> (2) There was no continuing obligation in the prior years to pay the salaries; and

(3) The back pay did not constitute 15% or more of gross income of the taxpayers for the years 1944 and 1945.

Upon the trial of the cases (which were consolidated in the Tax Court) the Tax Court concluded that the conditions affecting Commodore in the prior years were not similar to bankruptcy or receivership and that, consequently, Section 107(d) could not be availed of by any of the taxpayers. Having so concluded, the Tax Court made no findings on the other two issues.

This decision of the Tax Court was appealed by the taxpayers to this Court. Upon review of the matter, this Court reversed the decision of the Tax Court and remanded the cases for findings upon the other two issues. (*Estate of R. L. Langer, deceased, Eleanore Langer, executrix, et al. v. Commissioner of Internal Revenue,* 183 F. 2d 758.)

Upon remand, the Tax Court considered the two remaining issues and decided as follows:

(1) That there was a continuing legal obligation requiring Commodore to pay the salaries for the prior years;

(2) That the back pay received by the Langers in 1944 was more than 15% of their gross incomes for said year; and

(3) That the back pay received by the Lindseys in 1944 and 1945 was, in both years, less than 15% of their gross incomes [R. 49-63, Docket Number 12959; R. 15-29, Docket Number 12970; R. 15-29, Docket Number 12971].

In accordance with said findings and conclusions, the Tax Court entered decisions of overpayments by the Langers for the year 1944, and of deficiencies for the Lindseys for both 1944 and 1945 [R. 64-65, Docket Number 12959; R. 30, Docket Number 12970; R. 30, Docket Number 12971].

Thereafter petitions for review were filed by the Lindseys in their cases, and by the Commissioner of Internal Revenue in the *Langer* cases [R. 66-68, Docket Number 12959; R. 31-32, Docket Number 12970; R. 31-32, Docket Number 12971].

In the *Langer* cases the Tax Court found that the Langers were members of two joint ventures, one relating to the Clifton Hotel, in Los Angeles, and the other relating to the Figueroa Hotel, in Los Angeles. It further found that only the distributive shares of the Langers in the net profits of said joint ventures were includible in the Langers' gross income; and that, on the basis of these figures, the back pay received by the Langers in 1944 exceeded 15% of their total gross income. Decisions were entered in favor of the Langers [R. 15-29, Docket Number 12970; R. 15-29, Docket Number 12971].

C. Abbott Lindsey during the years 1944 and 1945 operated, as a sole proprietorship, a cafe at the Commodore Hotel. He and Mrs. Lindsey reported in Schedule "C" on page two (or three) of their Federal income tax returns the gross receipts and net profits realized from the operation of said cafe. They carried forward to page one of their returns for both years, and included as "income from other sources" at line four, the profit realized from the cafe operation. The back pay received by the Lindseys in 1944 and 1945 exceeded 15% of their "gross income" as shown on the face or page one of their returns. How-

ever, the Tax Court found that their "gross income" should be computed by taking into account not only the income from the cafe business carried forward by the Lindseys to and appearing on the first page of their returns, but also items deducted from the gross receipts of the cafe on Schedule "C" of their returns. These other business deductions amounted to $57,385.88 in the year 1944 and $65,564.72 in the year 1945. The Tax Court found that the gross income of the Lindseys for both years must include, so far as the cafe operation was concerned, the gross receipts from the cafe less only the amounts designated on Schedule "C" as "cost of goods sold." The cost of goods sold represented only inventory of food used in the cafe operations [R. 49-63, Docket No. 12959].

Having so expanded the Lindseys' "gross income", the Tax Court found that the back pay received by them was less than 15% of gross income. Accordingly, the application of Section 107(d) of the Internal Revenue Code was denied. The Tax Court entered judgments of deficiency in favor of the Commissioner of Internal Revenue [R. 64-65, Docket No. 12959]. The Lindseys in due course filed petitions for review of the decisions in their cases. The Commissioner of Internal Revenue filed petitions for review in the *Langer* cases.

Specification of Errors.

(1) The Tax Court erred in its conclusion that, for purposes of determining the application of Section 107(d) of the Internal Revenue Code, there must be included in the Lindseys' gross income anything more than the net profit from the operation of the cafe at the Commodore Hotel, which figure was brought forward from Schedule "C" of their respective returns to the first page thereof.

(2) The Tax Court erred in failing to find that the Lindseys have overpaid their federal income taxes for the calendar years 1944 and 1945.

Summary of Argument.

The term "gross income" is not defined in Section 107(d) of the Internal Revenue Code. The term has been given varying definitions depending upon the circumstances involved in particular cases and the statutory objectives under consideration.

The meaning of the term "gross income" as used in Section 107(d) must be ascertained in relation to the objectives of said section of the Code. The statutory purpose underlying Section 107(d) must be given great weight in the application of the statute to the facts involved in these or any other cases. The statute is remedial and should be interpreted so as to accomplish its remedial objective without discriminating between the taxpayers who were intended to be benefited.

The construction placed upon the statute by the Tax Court in the *Lindsey* cases frustrates the legislative purpose, and creates distinctions and discrimination where no such purposes can reasonably be attributed to the Congress.

Outline of Argument.

A. The term "gross income" is not defined in Section 107(d) of the Internal Revenue Code. Because it is not a term of uniform definition in the Internal Revenue Code, it is proper for this Court to determine its meaning as used in Section 107(d).

B. As used in Section 107(d) of the Internal Revenue Code, gross income means the sum of the income items appearing on page one of the taxpayer's return.

ARGUMENT.

A. The Term "Gross Income" Is Not Defined in Section 107(d) of the Internal Revenue Code. Because It Is Not a Term of Uniform Definition in the Internal Revenue Code, It Is Proper for This Court to Determine Its Meaning as Used in Section 107(d).

The question presented on these petitions for review is whether the amount of the back pay received by the taxpayers during the taxable years exceeds 15% of their respective gross incomes for such years. The Tax Court held that, in the case of the Langers, the back pay did exceed 15%; but that in the case of the Lindseys, it did not. The stated basis for distinction was that, though both the Langers and the Lindseys received income from business operations, that which was received by the Langers represented their shares of the net profits of joint ventures of which they were members, whereas that of the Lindseys was derived from a sole proprietorship operation.

Neither Section 107(d) nor the regulations promulgated thereunder defines the term "gross income" as used in the section. Section 22(a) of the Internal Revenue Code states that gross income includes gains, profits, and income derived from salaries, wages, or compensation for personal services, or from professions, vocations, trades, businesses, commerce, or sales or dealings in property, etc. Precisely what amount is to be included in the gains, profits, and income of an individual from business is not specified in Section 22(a) or elsewhere in the Internal Revenue Code.

Nevertheless, the Courts have been called upon in many cases other than the present ones to determine what is

gross income. What is gross income for purposes of one section of the Internal Revenue Code is not necessarily gross income for all purposes. This is well illustrated by the case of *Woodside Acres, Inc. v. Commissioner of Internal Revenue* (C. C. A. 2d, 1943), 134 F. 2d 793. The question before the court in that case was whether the petitioner was a personal holding company within the meaning of Section 352(a)(1) of the Revenue Act of 1936, as amended. The petitioner, a corporation, owned assets consisting of securities and a dairy farm. For the calender year 1937 it received as income $67,212.08 from dividends, interest, and rents (personal holding company income). It reported that amount, together with gross receipts from the operation of its dairy farm in the amount of $24,663.09. From its gross farm receipts, concerning which there was no dispute, it deducted only two small items, consisting of the cost of milk and cream purchased for resale and sold, and amounts paid for seed and plants. Its gross farm income, so computed, was $22,606.31. If that amount was the correct amount of its gross income from the dairy, the petitioner was not subject to the personal holding company surtax, because its personal holding company income was not 80% or more of "gross income."

The Commissioner, however, took the position that other items, consisting of the cost of feed used in the operation of the dairy farm and the cost of dairy labor, should have been deducted from gross receipts to arrive at the gross farm income. If either of said items (each amounting to approximately $5,000) should have been deducted from gross farm receipts, the petitioner would have been a personal holding company, and subject to the personal holding company surtax, because its income from securities would have exceeded 80% of its gross income.

The petitioner argued that the Commissioner's regulations, Article 22(a)-7 of Regulations 94 (the regulations in effect under the 1936 Revenue Act) dealing with the gross income and expenses of farmers, directed farmers to include in gross income their gross receipts; and that, therefore, the same interpretation of gross farm income should be applicable for purposes of the personal holding company surtax.

The Court of Appeals for the Second Circuit disagreed with the taxpayer, stating that:

> "This argument is indeed plausible but there are good reasons why it misses the mark. The regulations are perfectly clear and reasonable interpretations of the statutes they were originally drawn to interpret. And they continued to have the same virtue in respect to the 1937 Act so far as they were applicable. It is only necessary to confine their application to the subject they were designed to cover, *i. e.,* the computation of the taxable income of farmers. They were originally promulgated when it did not make any difference taxwise whether a corporation which was a farmer as defined in the regulations might derive all its income from farming or part in that way and part from securities in whatever proportion. It did not matter whether some subtraction was made from gross receipts to get what was called gross income from which other allowable deductions were made to arrive at net taxable income or whether the order of deduction was different and the amount of what was called gross income consequently different so long as net taxable income was the same. But when the taxation of personal holding companies as such began and what were such companies was made in part to depend upon the nature of the source of a given percentage of their gross income, it became

necessary in order to determine who was liable for such surtaxes, to make precise computations of gross income. No less was required by the need for classification of the taxpayer as, or as not, a personal holding company with the nature of the source of its gross income one of the factors to be given effect. Then regulations which were plainly promulgated to make it easy for farmers to report their farm income for taxation and still served that purpose were surely left to provide the same assistance to taxpayers and tax collectors. But they were not necessarily also extended to a situation as to which they were inadequate. Congress did not expressly do that when it provided that the terms used in Title IA should mean what the same terms meant when used in Title I. Farmers might still compute their net taxable income as the regulations did, and had, provided. Yet gross income so determined for that purpose did not become an immutable factor in determining whether a corporation which ran a farm was also a personal holding company. Congress made no mention of any regulations. *We are unwilling, therefore, to impute to it an intent to adopt apparently inapplicable regulations which define gross income for one purpose to provide the definition of gross income for the entirely new and different purpose of the personal holding company taxing statute.*" (Emphasis added.)

Here is explicit recognition that the term "gross income" may have different meanings depending upon the context in which it appears.

A further example is *Grange Trust v. Commissioner,* Tax Court Docket No. 111169, decided April 17, 1945 (Commerce Clearing House dec. 14,517(M), 4 T. C. M. 400; 1945 Prentice-Hall T. C. Memorandum Decisions,

page 451). Therein one of the questions involved was what constitutes gross income for purposes of Section 275(c) of the Internal Revenue Code (relating to the five year statute of limitations on assessment of deficiencies where amounts omitted from gross income exceed 25% of the taxpayer's gross income). The taxpayer in said case, in its fiduciary returns, reported on Schedule B rentals in the aggregate amount received; and the taxpayer deducted therefrom depreciation, repairs, taxes, expenses, and the like. The difference was entered on the face of the return. The Commissioner of Internal Revenue claimed in said case that there was an omission from gross income in excess of 25% in that gross receipts from rentals were not disclosed on the face of the return. The Tax Court rejected the Commissioner's contention and held that there had not been an omission in excess of 25%, thereby ruling that the five-year statute of limitations was not applicable. The Tax Court said, in its opinion:

> "In the two fiduciary returns filed by the trust—one for Grange Farm and one for Grange Development—rents in the aggregate amount of $54,698.74 were reported in Schedule B, and depreciation, repairs, taxes, expenses, etc., were deducted. There was entered on the face of the return the difference, an aggregate amount of $33,388.82. The respondent spells out of this an omission from gross income of $25,872.30 ($54,698.74—$33,388.82+$4,563.38), which, of course, is in excess of 25 per centum of the amount stated on the face of the return.

> "Petitioner does not agree with respondent's analysis of the facts nor do we. The form was filled out in accordance with the instructions. Obviously the responsible officers of the Treasury Department, who prepared the form, had in mind that the schedule should show the actual rentals received and the legal deductions and that there should be brought onto the face of the return only the true income resulting. *This, together with interest, capital gains, dividends, Net Profit (or Loss) from Trade or Business, and other income constituted the gross income of the trust.*" (Emphasis added.)

We thus have one case where "gross income" was held to mean one thing for the purposes of the personal holding company surtax and another case in which an entirely different meaning was imputed to the identical term where the statute of limitations was involved.

In the present cases it is entirely proper for the Court to examine the statute, ascertain its objectives, and apply its terms in the light of those objectives. The definition of gross income in Section 29.22(a)-5 of Regulations 111 is not applicable here. That section is concerned with gross income from manufacturing, merchandising, and mining. Its purpose is to define, as to such businesses, the Constitutional limits within which the income tax laws may operate. It contains no reference to Section 107(d) of the Internal Revenue Code; and has no necessary connection with it, or the relief it was designed to afford.

B. As Used in Section 107(d) of the Internal Revenue Code, Gross Income Means the Sum of the Income Items Appearing on Page One of the Taxpayer's Return.

Section 107(d) of the Internal Revenue Code is a relief provision. It provides, in effect, that if a salary earner does not, for specified reasons beyond his control, receive his compensation in the year in which he rendered services, but later receives that compensation, he shall not be required to pay income tax on such compensation in the year of receipt in an amount greater than he would have had to pay had he received the compensation in the earlier years to which the compensation is applicable. The section permits the computation of tax on such receipts at rates, and upon a basis, different from that otherwise prescribed. It is not an exemption provision, because it does not permit the exclusion of any amounts received from gross income. It is, however, a relief provision, which must be liberally construed to effectuate the objectives sought by the legislature. Mertens, *Law of Federal Income Taxation,* Volume 1, page 71; *Keeble v. Commissioner,* 2 T. C. 1249 (1943).

In the *Keeble* case, *supra,* the Tax Court was called upon to interpret Section 107(a) of the Internal Revenue Code (26 U. S. C. A., Section 107(a)). The Commissioner contended, in that case, that Section 107(a) was a provision granting an exemption from tax and that it should, therefore, be strictly construed. The Tax Court rejected this argument, saying in part:

> "The statute is remedial, granting relief to those coming within its terms. A remedial statute should be given a rational, sensible construction and one which will 'give the relief it was intended to pro-

vide.' *Bonwit Teller & Co. v. United States,* 283 U. S. 258; *F. Harold Johnston, Executor,* 33 BTA 551; *Michel J. A. Bertin,* 1 TC 355. 'Common sense interpretation is the safest rule to follow in the administration of income tax laws,' *Rhodes v. Commissioner,* 100 F. (2d) 966; and 'a desire for equality among taxpayers is to be attributed to Congress, rather than the reverse,' *Colgate-Palmolive-Peet Co.,* 320 U. S. 422."

Since it is apparent from reading them that all of the subsections of Section 107 of the Internal Revenue Code are directed toward the same objective, they should all be given the same sensible construction.

Examination of the legislative history of Section 107(d) reveals the Congressional intent that the section should not be restricted to the extent sought by the Commissioner. The provision first appeared as Section 113 of the House version of the Revenue Bill of 1943. In its original form it would have applied only to back pay received by an individual arising out of:

(1) Any alleged unfair labor practice of an employer under the National Labor Relations Act;

(2) Any alleged violation of Sections 6 or 7 of the Fair Labor Standards Act of 1938; or

(3) Any retroactive wage increase provided for by the National War Labor Board.

In other words, the House version covered only wage adjustments of the type described in Section 107(d)(2)(B) of the Statute as finally enacted.

The House proposal was eliminated by the Senate Finance Committee, with the following explanation (Senate Report No. 627, 78th Cong., 1st Sess.):

> "The House adopted a provision relating to the taxes on back pay received by an individual for services rendered in a prior year because of alleged unfair labor practice under the National Labor Relations Act, or a violation of the Fair Labor Standards Act, or a retroactive increase approved by the National War Labor Board. Your committee was unable to agree with this provision *because of its limited application* and it has, therefore, been omitted from the bill." (Emphasis added.)

Section 107(d) in its present form was added to the Revenue Act of 1943 by the Conference Committee (Amendment No. 30). The statement of the Conference Committee described the provisions of the section as agreed upon in committee. With respect to the 15% limitation, only the following statement was made:

> "The new subsection provides that if the amount of such back pay exceeds 15 percent of the gross income of the individual for the taxable year, the part of the tax for such year which is attributable to the inclusion of the back pay in gross income shall not exceed the sum of the increases in the taxes which would result from the inclusion of the respective portions of the back pay in gross income for the taxable years to which such portions are respectively attributable, as determined under regulations prescribed by the Commissioner with the approval of the Secretary."

It is significant that the Senate rejected the House version, which was of narrow application. The benefits of the relief provision as ultimately enacted were intended to

cover not only wage earners, but salary earners, professional men, business men, and the like. The only apparent explanation for the 15% limitation was to restrict the relief to those cases in which the amount of back pay is a significant factor in the computation of the *tax liability* of the individual. From the standpoint of the individual, the income brought forward to the face of his return, which is used by him as the starting point for the actual computation of his tax liability, is the significant figure, and the one which should logically be considered in applying the 15% rule.

Such must have been the intent of Congress when it enacted Section 107(d). As has already been stated herein, that code provision was added by the Revenue Act of 1943. The 1943 Act was first passed by Congress in the early part of February, 1944. It was vetoed on February 19, 1944, and became law on February 25, 1944, after passage over the veto.

At the time it was considering the Act, Congress had before it the method of reporting which had been in effect for many years prior to 1944, and which was in effect during the years involved in the *Grange Trust* case, *supra.* Such method involved bringing forward to the face of the return, among other items, net profit from a trade or business. It must have had in mind that the total of such income items would constitute the "gross income" to which the 15% limitation would be applied. Such a definition was adopted by the Tax Court in the *Grange Trust* case, *supra,* and is just as appropriate here; in fact, is the only definition which will result in a reasonable application of the law. True, that case involved rents whereas this one involves business income, but there is no difference between net rents and net business income.

The 1944 and 1945 individual federal income tax returns, Form 1040, showed, on page 1 (the front page of the return) first a space for listing the taxpayer and other persons for whom exemptions are allowable. At line 2 of page 1 of the return, space is provided for entering the taxpayer's total wages, salaries, etc. At line 3 there is a space for reporting dividends and interest, with the following notation:

> "3. Enter here the total amount of your dividends and interest (including interest from Government obligations unless wholly exempt from taxation)."

At line 4 there is a space provided for other income, with the following notation:

> "4. If you received any other income, *give details on page 3* (page 2 of the 1945 form) and enter the total here." (Emphasis added.)

At line 5 the taxpayer is instructed to "Add amounts in items 2, 3, and 4, and enter the total here." Lines 2, 3, and 4 of page 1 of the individual return are bracketed, and opposite the bracket there is the statement in heavy type "your income."

On page 3 of the return form (page 2 in the 1945 form) there are schedules headed as follows:

Schedule A—Income from annuities or pensions.

Schedule B—Income from rents and royalties.

Schedule C—Profit (or Loss) from Business or Profession.

Schedule D—Gains and losses from sales or exchanges of capital assets, etc.

Schedule E—Income from partnerships, estates, and trusts, and other sources.

At the bottom of said schedules there appears in heavy type the following language:

> "Total income from above sources (enter as item 4, page 1)."

It is interesting to note that Schedule C does not use the term "gross income." The terminology used is "total receipts" (line 1); "gross profit" (line 10); and "net profit" (line 22).

The returns of the Lindseys and the Langers were prepared on Forms 1040 in accordance with the instructions laid down by the Commissioner of Internal Revenue. The details of business and income from joint ventures were disclosed by the taxpayers on page 2 (or 3, as the case may be) of their respective returns. They then carried forward to page 1 of their returns, at line 4, the income so detailed. This was not only required by the form but also determined the amount of gross income which these individuals received for purposes of Section 107(d).

The case of *Grange Trust v. Commissioner* has already been referred to in this brief, *supra*. The Tax Court stated, in that case that true income from rents was actual rentals received less legal deductions; and that "this, together with interest, capital gains, dividends, Net Profit (Or Loss) from Trade or Business, and other income constituted the gross income * * *." Certainly the method of reporting income prescribed by the Commissioner of Internal Revenue would lead to the conclusion that the applicability of a relief provision such as Section 107(d) is to be determined in relation to the income appearing on the first page of the individual return.

The function of Section 107 of the Internal Revenue Code is to ease the tax *burden* of described taxpayers.

That burden is measured by rates applied to net taxable income. In the enactment of Section 107(d) Congress adhered to its purpose of alleviating the tax burden in special circumstances by extending the relief provision to cover back pay. The section was to be applicable to the individual only if the tax for the year in which back pay is received (based on net income) is heavier without computing the tax under the special method prescribed.

When the additional requirement that the back pay be more than 15 per cent of gross income was inserted, Congress likewise must have been thinking in terms of the tax burden. Therefore, the gross income of which the statute speaks must be the amount of income shown on page one of the tax return, from which allowable deductions, such as contributions, taxes, medical expenses, and the like, are subtracted to arrive at net income. Congress must have thought that when the back pay exceeds 15 per cent of that gross income figure the tax burden resulting from the receipt in the taxable year of the back pay is sufficient to warrant relief. So read, the statute effectuates the legislative purpose to afford relief where an undue burden of tax would otherwise have to be shouldered; and a rational, sensible result is accomplished.

An absurd purpose and an irrational result are ascribed to the legislature by the Commissioner. Suppose, for example, that an individual operating a proprietorship business has total receipts for a taxable year of $1,000,000, cost of goods sold of $750,000 and other business deductions of $250,000. He has realized no profit from his business operation. Further assume that he received back pay during the taxable year in the amount of $35,000, attributable to several prior years, and that he has no income from other sources. Under the Commissioner's

view, even though the only figure appearing on the face of the individual's return is the $35,000 of back pay, he would not be entitled to apply Section 107(d) because the back pay would be less than 15% of "gross income" as the term is interpreted by the Commissioner. Yet here is an individual who would seem to be as deserving of the relief of the section as, for example, the taxpayer involved in the case of *Kenny v. Commissioner*, 4 T. C. 750 (1945), which decision is discussed at length in this Court's opinion on the first appeal of the instant cases.

The Tax Court called attention to the fact that the statute speaks of "gross income" rather than "adjusted gross income." The concept of adjusted gross income was not in the Internal Revenue Code when Section 107(d) was enacted, but came later when Section 22(n) was added to the Code by the individual Income Tax Act of 1944.

Furthermore, petitioners do not make any contention that "adjusted gross income," as such, is the item to which the 15% is to be applied. It is submitted, merely, that "gross income," for the purpose of Section 107(d), should be defined as hereinabove set forth.

The decisions of the Tax Court in these cases illustrate the anomalous consequences of the interpretation sought by the Commissioner. Both Langer and Lindsey received equal amounts of back pay during the years involved. Each of them had income from other business operations. As a result of what might be called the purely fortuitous circumstance in the *Langer* case of that business income being from joint ventures, instead of proprietorships, the Tax Court decided in favor of the Langers. The percentage of the income appearing on page one of the Lindsey returns represented by back pay was sub-

stantially greater than that of the Langers; and it would seem only logical that their right to relief should be the same as that of the Langers. Yet as a consequence of what is believed to be a purely technical difference, the Lindseys have been denied relief. If the United States Supreme Court was correct in saying, in *Colgate-Palmolive-Peet Company v. United States,* 320 U. S. 422, 64 S. Ct. 227 (1943), that "a desire for equality among taxpayers is to be attributed to Congress, rather than the reverse," then it is submitted that the decisions of the Tax Court below should have been in favor of the Lindseys as well as the Langers.

Respectfully submitted,

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September 5, 1951.

APPENDIX.

Section 107, Internal Revenue Code.

Sec. 107. Compensation for Services Rendered for a Period of Thirty-six Months or More and Back Pay.

(d) BACK PAY—

(1) IN GENERAL—If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 per centum of the gross income of the individual for such year, the part of the tax attributable to the inclusion of such back pay in gross income for the taxable year shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable, as determined under the regulations prescribed by the Commissioner with the approval of the Secretary.

(2) DEFINITION OF BACK PAY—For the purposes of this subsection, "back pay" means (A) remuneration, including wages, salaries, retirement pay, and other similar compensation, which is received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which would have been paid prior to the taxable year except for the intervention of one of the following events: (i) bankruptcy or receivership of the employer; (ii) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings; (iii)

if the employer is the United States, a State, a Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any of the foregoing, lack of funds appropriated to pay such remuneration; or (iv) any other event determined to be similar in nature under regulations prescribed by the Commissioner with the approval of the Secretary; and (B) wages or salaries which are received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which constitute retroactive wage or salary increases ordered, recommended, or approved by any Federal or State agency, and made retroactive to any period prior to the taxable year; and (C) payments which are received or accrued during the taxable year as the result of an alleged violation by an employer of any State or Federal Law relating to labor standards or practices, and which are determined under regulations prescribed by the Commissioner with the approval of the Secretary to be attributable to a prior taxable year. Amounts not includible in gross income under this chapter shall not constitute "back pay."

Regulations 111.

Reg. 111, Sec. 29.107-3. Back pay attributable to prior taxable years. Section 107(d)(2) defines "back pay" and Section 107(d)(1) limits the amount of tax resulting from the inclusion of such back pay in gross income for the year in which it is received or accrued. Back pay includes compensation, wages, salaries, pensions and retirement pay received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which would have been paid prior to the taxable year but for the intervention of any one of the following events: (1) bankruptcy or receivership of the employer; (2) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings; (3) if the employer is the United States, a State, a Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrurmentality of any of the foregoing, lack of funds appropriated to pay such remuneration; or (4) any other event determined to be similar in nature under these regulations. As to what constitutes bankruptcy and receivership proceedings see Section 29.274-1.

An event will be considered similar in nature to those events specified in Section 107(d)(2)(A)(i) (ii) and (iii) only if the circumstances are unusual, if they are of the type specified therein, if they operate to defer payment of the remuneration for the services performed, and if payment, except for such circumstances, would have been made prior to the taxable year in which received or accrued. For the purposes of this section the term "back pay" does not include remuneration which is deemed to be constructively received in the taxable year or years

in which the services were performed, remuneration paid in the current year in accordance with the usual practice or custom of the employer even though received in respect of services performed in a prior year or years, additional compensation for past services where there was no prior agreement or legal obligation to pay such additional compensation, or any amount which is not includible in gross income under chapter 1.

The term "back pay" also embraces retroactive wage or salary increases received or accrued in respect of services performed by an employee for his employer in a prior taxable year which have been ordered, recommended, or approved by any Federal or State agency such as, but not limited to, the War Labor Board or any regional War Labor Board, the Salary Stabilization Unit of the Bureau of Internal Revenue, and boards authorized by the Railway Labor Act (44 Stat. 577), as amended (45 U. S. C., 1940 ed., ch. 8), comparable State organizations, and United States and State courts; payments made as a result of alleged violations of Sections 6 and 7 of the Fair Labor Standards Act of 1938 (52 Stat. 1062 and 1063, as amended; 29 U. S. C., 1940 ed., secs. 206 and 207), and made retroactive to any period prior to the taxable year; and payments which are received or accrued during the taxable year arising out of an alleged violation by an employer of any State or Federal law relating to labor standards or practices, such as payments received to effectuate the policies of the National Labor Relations Act (49 Stat. 449), as amended (29 U. S. C., 1940 ed., secs. 151-166). The term "wage or salary increases" as used in this section includes payments not made until after the close of the taxable year on account of regulations, orders or rulings under the Inflation Control Act of 1942 (56

Stat. 765; 50 U. S. C., App., Supp., secs. 961-971) even though the total amount paid for the services rendered does not exceed the amount payable by contract or under established policy.

An individual must compute his net income for any taxable year to which back pay is attributable, even though he was not required to make a return for such year. Thus, all amounts properly includible as gross income for any taxable year to which back pay is attributable must be included in the computation.

For the purpose of determining under Section 107(d) the particular taxable year or years to which the back pay is attributable and, if such back pay is attributable to more than one taxable year, the amount thereof which is attributable to each of such taxable years, the following rules will be applicable:

(1) Back pay, as defined under Section 107(d)(2)(A), shall be deemed to be attributable to a particular taxable year in the amount and to the extent that it would have been paid in such year except for the intervention of one of the events described in Section 107(d)(2)(A).

(2) Back pay, as defined under Section 107(d)(2)(B), shall be deemed to be attributable to a particular taxable year in the amount and to the extent that it would have been paid in such year had the wage or salary increase as described in Section 107(d)(2)(B) been actually put into effect on the date to which it was first made retroactive.

(3) Back pay, as defined under Section 107(d)(2)(C), shall be deemed to be attributable to a particular taxable year in the amount and to the extent that it represents payments in respect of the alleged violation described in

Section 107(d)(2)(C) which occurred in such year or which continued during any part of such year.

(4) In those cases where a computation has been made by, or under the direction of, a Federal or State agency (including any Federal or State court) under which the back pay was awarded, which indicates that particular portions of such back pay are attributable to certain definite periods of time, such computation shall be accepted as the appropriate apportionment for the purposes of these regulations.

(5) Where no such computation has been made as provided in (4), and where the apportionment cannot be accurately made upon consideration of all the attendant circumstances in accordance with the applicable rule prescribed in (1) (2) or (3), then in proper cases the back pay shall be apportioned to each of the taxable years within which fall one or more calendar months included within the entire period for which such back pay has been paid, as if such back pay had been received or accrued in equal portions in each of such calendar months. For the purposes of this section, a fractional part of a month is to be disregarded unless it amounts to more than half a month, in which case it is to be considered as a month.

The first step in determining whether Section 107(d) is applicable is the determination of the percentage which the back pay is of the gross income of the taxpayer for the current taxable year. It must exceed 15 per centum of such gross income. The amount of the tax attributable to such back pay is the difference between the tax for the taxable year computed with the inclusion of such back pay in gross income and the tax for such taxable year computed without including such back pay in such gross income.

The amount of the tax attributable to such back pay in each taxable year is the difference between the tax for such taxable year computed with the inclusion in gross income of the portion of such back pay attributable to such taxable year and the tax for such taxable year computed without including any part of such back pay in gross income.

The tax for the current taxable year is (1) the tax computed with the inclusion in gross income of the entire back pay received or accrued in the taxable year, or (2) the tax computed without including any such back pay in gross income for the current taxable year, plus the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for each taxable year to which each such portion is respectively attributable, whichever is the smaller.

This may be illustrated by the following example in which the taxpayer makes his returns on the cash receipts and disbursements basis, and in which it is assumed that he is entitled to use and uses for the taxable years 1944 and 1941 the alternative tax provided in Supplement T:

EXAMPLE: In 1944 a single person with no dependents who makes his income tax returns on the calendar year basis receives $2,900, which amount constitutes his adjusted gross income. Of this amount $500 constitutes back pay. His tax for the calendar year 1944 on $2,900 would be $490. On $2,400 ($2,900 minus $500) the tax would be $384. That part of the tax for 1944 attributable to back pay is therefore $106 ($490 minus $384). Of the back pay $300 is attributable to the year 1941. During such year he had received $2,000. For such year the

amount of tax on $2,000 is $104. The amount of tax which he would have paid for such year had he included in gross income the portion of back pay attributable to such year would be $130. The increase in the tax for such year would be $26 ($130 minus $104).

The remainder of the back pay, $200, is attributable to the calendar year 1940. During such year his net income was $1,800. For such year the amount of tax, including the defense tax, on $1,800 is $36.08 and the amount of tax including the defense tax, which he would have paid for such year had he included in gross income the portion of back pay attributable to such year would be $44. The increase in the tax for such year would be $7.92 ($44 minus $36.08). The aggregate of increases in the taxes for the calendar years 1941 and 1940 would be $33.92. The tax for the calendar year 1944 is the smaller of $384 plus (1) $106 or (2) $33.92. Since $33.92 is smaller than $106 the tax for the calendar year 1944 is $417.92 ($384 plus $33.92).

Section 6(d)(3) of the Current Tax Payment Act of 1943, as amended by Section 506(b) of the Revenue Act of 1943, provides that Section 107 of the Internal Revenue Code shall be applied without regard to subsections (a) and (b) of Section 6 of the Current Tax Payment Act of 1943. For example, a taxpayer who had received or accrued compensation including back pay in 1943 determines his income tax, including the victory tax, for such year in the manner provided in Section 107 of the Internal Revenue Code before the application of Section 6. In the process of determining such tax, portions of such compensation are attributable to prior years and the limitation upon the increase in the tax for 1943 attributable to such compensation is determined by reference to

the tax for the respective years computed upon the portion of such compensation allocable to such years. While all of such compensation is included in gross income for 1942 or 1943, as the case may be, such compensation is attributable to prior years without regard to Section 6 of the Current Tax Payment Act of 1943. This may be illustrated by the following example in which the taxpayer makes his returns on the cash receipts and disbursements basis, and in which it is assumed that he is entitled to use and uses for the taxable years 1943, 1942 and 1941 the alternative tax provided in Supplement T:

EXAMPLE: In 1943 a single person (not the head of a family) who makes his income tax returns on a calendar year basis receives $2,200. Of this amount $600 constitutes back pay. Including the victory tax, his tax liability for 1943 on $2,200 would be $342.10. On $1,600 ($2,200 minus $600) the tax liability would be $216.60. That part of the tax liability for the calendar year 1943 attributable to back pay is therefore $125.50 ($342.10 minus $216.60). Of the back pay $400 is attributable to the calendar year 1942. During such year he had received $1,000. For the calendar year 1942 the amount of tax liability on $1,000 is $76. The amount of tax liability for such year had he included in gross income the portion of back pay attributable to the calendar year 1942 would be $145. The increase in the tax liability for such year would be $69 ($145 minus $76).

The remainder of back pay, $200, is attributable to the calendar year 1941. During such year he had received $1,000. For such year the amount of tax on $1,000 is $18, and the amount of tax which he would have paid for such year had he included in gross income the portion of back pay attributable to the year 1941 would be $35. The

increase in the tax for such year would be $17 ($35 minus $18). The aggregate of the increases in the taxes for the calendar years 1942 and 1941 would be $86. The tax liability for the calendar year 1943 is the smaller of $216.60 plus (1) $125.50 or (2) $86. Since $86 is smaller than $125.50, the tax liability for the calendar year 1943, prior to the application of Section 6 of the Current Tax Payment Act of 1943, is $302.60. For the application of Section 6 of the Current Tax Payment Act of 1943, see the regulations thereunder, set forth in Treasury Decision 5300, approved October 1, 1943, and amendments thereto.

Nos. 12959, 12970, 12971

In the United States Court of Appeals for the Ninth Circuit

C. Abbott Lindsey and Pauline Lindsey, *Petitioners*

v.

Commissioner of Internal Revenue, *Respondent*

Commissioner of Internal Revenue, *Petitioner*

v.

Eleanore Langer, *Respondent*

Commissioner of Internal Revenue, *Petitioner*

v.

Estate of R. L. Langer, Deceased;
Eleanor Langer, Executrix, *Respondent*

On Petitions for Review of the Decisions of the Tax Court of the United States

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BRIEF FOR THE COMMISSIONER OF INTERNAL REVENUE

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In the United States Court of Appeals for the Ninth Circuit

C. ABBOTT LINDSEY and PAULINE LINDSEY, *Petitioners*

v.

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COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

ELEANORE LANGER, *Respondent*

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

ESTATE OF R. L. LANGER, DECEASED;
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On Petitions for Review of the Decisions of the Tax Court of the United States

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BRIEF FOR THE COMMISSIONER OF INTERNAL REVENUE

PREVIOUS OPINIONS

The original opinion of the Tax Court (R. 85-97, No. 12456) is reported at 13 T. C. 419. The opinion of this Court on appeal from the decisions therein is reported

at 183 F. 2d 758. The opinion of the Tax Court on remand (R. 15-29, No. 12970)[1] is reported at 16 T. C. 41.

JURISDICTION

These petitions for review (R. 66-68, No. 12959; R. 31-32, Nos. 12970, 12971) involve federal income taxes for the years 1944 and 1945. On September 24, 1947, and February 19, 1948, the Commissioner of Internal Revenue mailed to taxpayers notices of deficiency in the total amount of $16,002.32. (R. 6-9, 16-19, 26-31, 50-55, No. 12456.) Within ninety days, respectively, thereafter and on December 17, 1947, and May 11, 1948, taxpayers filed petitions with the Tax Court for redeterminaton of the particular deficiency asserted against each under the provisions of Section 272 of the Internal Revenue Code. (R. 2-9, 11-19, 20-31, 44-55, No. 12456.)[2] The decisions of the Tax Court affirming the Commissioner's determination of deficiency were entered September 29, 1949. (R. 98, 99, 100, 101, No. 12,456.) These cases were brought to this Court by a petition for review filed December 6, 1949 (R. 102-107, No. 12456), pursuant to the provisions of Section

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[1] To avoid confusion, when references are made in this brief to the opinion of the Tax Court on remand, we shall refer to the record in Docket No. 12970. Although we moved this Court for consolidation of the cases herein, in order to avoid unnecessary duplication, inadvertantly the opinion of the Tax Court was printed three times, in each of the volumes of printed record herein.

[2] Page 55 of the printed record in Docket No. 12456 reads that one of the petitions for a redetermination of deficiency was filed May 11, 1949. A check of the docket entries in the Tax Court reveals that this is a typographical error, the correct date of filing being May 11, 1948.

1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

On appeal this Court remanded to the Tax Court. On remand the Tax Court on April 3, 1951, entered decisions of deficiency in income tax with respect to the Lindseys (R. 64, 65, No. 12959) and of overpayment of income tax with respect to the Langers (R. 30, Nos. 12970, 12971). The cases are brought to this Court for a second time by petitioners for review filed May 2, 1951 (R. 66-68, No. 12959), and May 3, 1951 (R. 31-32, Nos. 12970, 12971), pursuant to the provisions of Section 36 of the Act of June 25, 1948. Although three separate petitions for review were filed, this Court subsequently consolidated the cases on motion of the Commissioner of Internal Revenue.

QUESTIONS PRESENTED

Whether back pay received by taxpayers in 1944 and 1945 exceeded 15% of their gross income for those years as that term is used in Section 107(d) of the Internal Revenue Code. This in turn depends upon:

1. Whether, in the case of the Lindseys, their gross income from the Commodore Cafe operated as a sole proprietorship, is to be computed by subtracting only the cost of goods sold from gross receipts, or whether other business deductions should also be made; and

2. Whether, in the case of the Langers, who operated properties as joint ventures, their shares of the gross income of the ventures should be considered a part of their gross income or whether they should include in gross income only their net distributive shares from the venture.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and Regulations may be found in the Appendix, *infra*.

STATEMENT

The facts, as found by the Tax Court in the original proceedings (R. 87-93, No. 12456) and as relevant on these petitions for review, may be summarized as follows:

R. L. Langer, now deceased, and C. Abbott Lindsey were, during the taxable years involved, officers and employees of Commodore Hotel Company, Ltd., a California corporation. Although they claimed to be entitled to certain sums by way of salary—$600 per month—neither received any salary during the years from 1938 through 1942. In each of those years, through 1941, Commodore showed operating losses, its balance sheets showing continuing deficits. Throughout the period, the corporation's hotel building, fixtures, and furnishings were subject to a deed of trust and chattel mortgage securing a promissory note payable to Pacific Mutual Life Insurance Company on which Commodore was chronically in default. Commodore realized in 1942 for the first time for a number of years operating profits after making the required installment payments to Pacific. As a result, in 1943 it became able to resume salary payments to Langer and Lindsey. In January, 1944, moreover, the board of directors ordered payment of the accrued back salaries as rapidly as the corporation's financial condition would warrant. Pursuant to this action, Langer and Lindsey each received, in addi-

tion to current salaries, $10,000 in 1944, and Lindsey $11,500 in 1945. (R. 88-91, No. 12456.)

In their tax returns for 1944 Langer and wife and Lindsey and wife each reported $5,000 as his or her community share of the back payments and computed the tax thereon at the rates applicable to the years for which the salary was paid, claiming the benefits of Section 107(d) of the Internal Revenue Code. Lindsey and wife proceeded similarly with respect to the year 1945. The Commissioner, however, holding that Section 107(d) was not applicable, determined tax deficiencies for the years 1944 and 1945. (R. 91-93, No. 12456.) The Tax Court sustained the Commissioner, holding that Commodore's failure to pay Langer and Lindsey their authorized salaries in the years 1938 through 1942 was the consequence of a restraint voluntarily imposed upon itself, and not the result of a legally enforceable external restriction such as the court thought essential to bring the case within the orbit of Section 107(d). (R. 93-97, No. 12456.) This holding the Court of Appeals for the Ninth Circuit reversed, considering the requirements of the statute satisfied, and remanded to the Tax Court to dispose of issues which that court had not reached.

On remand, the Tax Court determined (R. 15-29, No. 12970), in taxpayer's favor, that the back pay received by Langer and Lindsey was paid pursuant to prior agreement and legal obligation. With respect to the Lindseys, the Tax Court determined that the back pay was less than 15% of gross income, and that they were therefore not entitled to the benefit of Section 107(d). With respect to the Langers, however, the Court deter-

mined that the back pay was in excess of 15% of gross income, and the benefits of Section 107(d) were therefore available to them. The Lindseys appealed to the Ninth Circuit; the Commissioner filed petitions for review in the Langer cases.

The Tax Court found additional facts on remand. As important herein, they are (R. 22-23, No. 12970):

> The Clifton Hotel was operated as a joint venture in 1944 by the Langers in conjunction with Nelda Clinton and Mary R. Brown. The Figueroa Hotel was operated as a joint venture in 1944 by the Langers in conjunction with Clifford Clinton and R. M. Callicott. The Langers' distributive share of the net profits in that year from such joint ventures was $7,249, or $3,624.50 apiece, from the Clifton Hotel, and $31,220.71, or $15,610.35 apiece, from the Figueroa Hotel.
>
> The back pay of $10,000 received by R. L. Langer in 1944 from the Commodore Hotel Company, allocable $5,000 to R. L. Langer and $5,000 to Eleanore Langer, comprised more than 15 per cent of their respective gross incomes of $30,729.45 and $31,854.43.
>
> The gross income reported by the Lindseys in 1944 was $44,183.52, or $22,091.76 apiece. Their gross income for 1944 was actually $101,569.40 or $50,784.70 apiece, computed to include "other business deductions" of the Commodore Cafe, amounting to $57,385.88. The back pay of $10,000 received by C. Abbott Lindsey in 1944 from the Commodore Hotel Company, allocable $5,000 to Lindsey and $5,000 to Pauline Lindsey, comprised less than 15 per cent of such gross incomes.
>
> In 1945 the total receipts of the Commodore Cafe, as reported by the Lindseys, were $144,897.95,

cost of goods sold $58,911.83, other business deductions $65,564.72. The gross income reported by the Lindseys in 1945 was $52,493.82, or $26,246.91 apiece. Their gross income for 1945 was actually $118,058.54, or $59,029.27 apiece, computed to include "other business deductions" of the Commodore Cafe, amounting to $65,564.72. The back pay of $11,500 received by C. Abbott Lindsey in 1945 from the Commodore Hotel Company, allocable $5,750 to Lindsey and $5,750 to Pauline Lindsey, comprised less than 15 per cent of such gross income.

STATEMENT OF POINTS TO BE URGED BY THE COMMISSIONER

The Tax Court erred in holding that the "back pay" received by the Laugers in 1944 exceeded 15% of their gross income in that year. Accordingly, the Tax Court erred in its determination that each of the Langers had overpaid his income taxes for that year.

SUMMARY OF ARGUMENT

The sole issue herein is what constitutes gross income under Section 170(d) of the Internal Revenue Code. Gross income ordinarily connotes something different from gross receipts, for it more nearly connotes gain than gain plus return of capital. Accordingly, the authorities define business gross income as gross receipts less the cost of goods sold, the cost of goods sold properly being considered the return of direct outlay of capital. This concept of gross income has stood unchallenged for many years, and the Tax Court's treatment of the Lindseys' gross income is consistent with it.

On their returns for the years 1944 and 1945 the Lindseys deducted from gross receipts the cost of the

goods sold in their restaurant business to arrive at gross profit. Further following good accounting practice, they deducted indirect operating expenses from gross profit to arrive at net profit. But they erroneously argue that only the net profit should be included in their individual gross income. It is clear from the authorities that for purposes of their business and their individual returns, gross income is synonymous with gross profit.

Taxpayers' argument that individual gross income is the sum of income items appearing on page one of the individual tax returns for the years 1944 and 1945 is erroneous. This sum is, instead, denominated by the Internal Revenue Code as adjusted gross income. It is clear not only from the words used but from other sections of the Code that adjusted gross income is something different from both net income and gross income. In fact the Code defines adjusted gross income as something considerably less than gross income. It is also something more than net income.

We believe the Tax Court erred in holding that because the Langers were joint ventures they need only include in their individual gross income their distributive shares of the net income of the joint ventures. Instead they should include their shares of the venture gross income in their individual gross income. This position is supported by prior rulings of the Bureau of Internal Revenue. We contend that both the Langers and Lindseys should report a similar gross income; the forms of their doing business, in the ascertainment of gross income, do not in the instant case make any difference. The distinction between their forms of

doing business is not like that between doing business as an individual or receiving income by way of corporate dividends. In ascertaining net income from their joint ventures, the Langers deducted all the expenses of operation. It is clear from the items deducted that while they are deductible from gross receipts to arrive at net income, many, if not most, of them are not deductible from gross receipts in order to ascertain gross income, for many of the deducted items are indirect costs of operation or overhead. It would take but a small sum to increase the Langers gross income to a point beyond that which bars to them the benefits of Section 107(d), and their returns for the year 1944 indicate more than enough that should have been added to gross income to increase their individual gross income to that extent.

ARGUMENT

The Tax Court Properly Defines Gross Income in the Case of the Lindseys as Gross Receipts Less the Cost of Goods Sold, but Erroneously Failed to Apply this Concept to the Langers

There is no dispute with respect to the facts herein. The issue before the Court calls for a determination of what constitutes gross income within the meaning of Section 107(d) of the Internal Revenue Code (Appendix, *infra*). That section provides that if an individual receives back pay in excess of 15% of his gross income for the year of receipt, he is entitled to the benefits of the section, provided certain other conditions, all met herein, are satisfied.

Taxpayers argue that the Lindseys should be entitled to deduct from gross receipts of their Commodore Cafe business not only the cost of goods sold, but also other

business deductions. In other words, taxpayers argue that only net profits of the business, rather than gross profits, should be included in individual gross income. It is our position, however, that the Tax Court properly included gross profit in gross income.

With respect to the Langers, we disagree with the Tax Court's determination that only their net distributive share of the joint ventures in which they were engaged should be included in gross income. Similarly as we contend in the Lindsey cases, we contend that the Langers' distributive share of the gross profit of the joint venture should be included in their gross income, not just the net profit.

Initially, before undertaking a discussion of the method of reporting income chosen by the Lindseys and the Langers, we must determine what gross income is within the meaning of Section 107(d). Logically, and the provisions of Section 22(a) of the Code defining gross income as gains, profits, and income from various sources and any source whatever lend the logic further support, gross income ordinarily connotes something different from gross receipts. *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, 335. The Court there rejected the contention that all receipts—"everything that comes in"—are income within the proper definition of the term gross income. Thus in *Doyle* v. *Mitchell Brothers Co.,* 247 U. S. 179, the Court stated (p. 185):

> In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.

And in *Snyder* v. *Commissioner,* 295 U. S. 134, the Court observed (p. 141, fn. 4):

> Proceeds from sales in the regular course of business constitute gross income of the business only to the extent that they exceed the cost of the goods sold. See *Spring City Foundry Co.* v. *Commissioner,* 292 U. S. 182, 185. * * *

We may safely conclude that ordinarily a taxpayer's gross income consists of his gross receipts less those receipts which constitute a return of the capital investment or the capital expended directly in production of income-producing goods. See Holmes, Federal Income Tax (Sixth ed.) 501.

The Treasury Regulations have accepted this concept. Treasury Regulations 111, Section 29.22(a)-5. Gross income is there defined, in the case of a manufacturing, merchandising, or mining business, as the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. This concept was applied by the Tax Court below with regard to the Lindseys. It accords with settled and unchallenged Bureau policy. See Mim. 2915, I-1 Cum. Bull. 233 (1922); I. T. 1241, I-1 Cum. Bull. 34 (1922). It may be noted that Mim. 2915 also states, in addition to accepting the concept of gross receipts less cost of goods sold, as follows:

> A lawyer, who is married and living with his wife, has gross receipts in the form of fees amounting to $6,000, and his necessary business expenses amount to $4,200, leaving a net income of only $1,800. A return would be required in this case [under Section 223(a) of the Revenue Act of

1921], as the taxpayer's gross income as well as gross receipts is $6,000.

Likewise, this concept of computing gross income accords with that upheld by the court in *Woodside Acres* v. *Commissioner,* 134 F. 2d 793 (C. A. 2d), relied on with such emphasis by taxpayers (Br. 10-12). The court there upheld the Commissioner's argument that accountants recognize direct costs in milk production which may be separated from the indirect or overhead expenses of farm operations. The direct costs, we argued therein, are (1) feed and (2) labor, in contrast to buildings, equipment, repairs, depreciation, bedding, supplies, delivery expenses, etc., which are indirect costs, citing Larsen, Milk Production Cost Accounts, pp. 2-3, 24-26, 38-45. The court held that feed and labor costs in the milk business should be deducted from gross receipts to ascertain gross income, in effect calling feed and labor in that business part of the cost of goods sold.

(1) On their returns for the taxable years involved (Ex. A-3, A-4, A-5, A-6), the Lindseys deducted from the gross receipts of the Commodore Cafe sole proprietorship not only the cost of goods sold but also other business expenses, i.e., operating expenses. We submit that under the foregoing authorities, the resulting figure is not gross income from the business but net income therefrom. The Commissioner disallowed, and in this was properly upheld by the Tax Court below, the deduction of anything but the cost of the goods sold. What is called on the tax return form gross profit is the equivalent of gross income, as the authorities indicate; for Schedule C of Form 1040, as used in 1944 and

1945 (See Ex. A-1, A-2, A-3, A-4, A-5, A-6), calls for the deduction of the cost of goods sold from gross receipts in order to determine gross profit. From gross profit, the Lindseys were entitled to deduct overhead expenses in order to ascertain their net income from the business. They conceded below that if the proper method of computation envisioned the subtraction of cost of goods sold from gross receipts, they were not entitled to the relief of Section 107(d). As we have demonstrated, that is the proper computation method. We feel constrained to emphasize that the accounting practice followed by the Lindseys to ascertain gross profit was proper accounting practice. Properly, to determine profit and loss in restaurant businesses, cost of food sales is first subtracted from gross receipts; the balance is closed out to an operation expenses account, which collects on its ~~debt~~ side all the indirect costs, or costs of operation, such as wages, cleaning, music, light and heat, laundry, silver, chinaware, etc. The balance of this account determines net profit or loss. III Kester, Accounting Theory and Practice (1921 ed.), p. 513.

Taxpayers' argument boils down to two propositions: the first, that gross income is not an immutable term; the second, that for purposes of Section 107(d) an individual taxpayer's gross income constitutes the sum of income items appearing on page one of the individual income tax return, Form 1040, as used in 1944 and 1945 (See Ex. A-1, A-2, A-3, A-4, A-5, A-6).

As taxpayers point out in their brief (pp. 19-20), page one of the return includes as income a taxpayer's total wages, salaries, etc.; the total amount of interest

and dividends; and any other income, the details of which are to be given in schedules within the return. These schedules, A through E, provide for the computation of net income from various sources, including rents and royalties and business or profession. Taxpayers also point out that the standard Form 1040 describes the sum of these items on page one as "your income."

But the sum of the items of income on page one of the return is neither gross income nor net income. On page four of Form 1040 as used in 1944 and on page three of that form as used in 1945, the sum of the income items on page one is denominated "This is your Adjusted Gross Income." To describe adjusted gross income as net income or gross income obviously is erroneous.

The terminology describing the income items on page one as adjusted gross income is consistent with and demanded by acts of Congress. By Section 8 of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231, Congress introduced the concept of adjusted gross income. By express terms of Section 2 of that Act amendments made therein applied for taxable years beginning after December 31, 1943, therefore covering the taxable years involved herein. Section 8 of the Act by its terms defines adjusted gross income for purposes of Chapter 1 of the Internal Revenue Code. It also introduces a new concept—adjusted gross income—into the revenue laws. H. Rep. No. 1365, 78th Cong., 2d Sess. p. 24 (1944 Cum. Bull. 821, 838). Taxpayers note that the concept of adjusted gross income was not in the Internal Revenue Code when Section 107(d) was en-

acted (Br. 22.) But the Individual Income Tax Act of 1944 made some changes and, significantly, did not make others. The concept of adjusted gross income was introduced into Section 23(o) and (x) of the Code by Section 8(b) and (c), permitting, respectively, deduction of charitable contributions limited to a percentage of adjusted gross income and permitted medical expense deduction of amounts in excess of 5% of adjusted gross income. The concept of adjusted gross income was also introduced into Section 23(aa) of the Code by Section 9 of the Act. The Act amended, by Section 8(d), Section 117(d)(2) of the Code in such a way as to suggest that adjusted gross income was considered by Congress more nearly in the nature of net than gross income, for it provided therein that for certain purposes net income as used in that section should be read as adjusted gross income. This is consistent with Congressional treatment of Section 23(o) and (x) of the Code under the Act, for previously the percentages involved in those sections had been percentages of net income, and became percentages of adjusted gross income under the Act, as we have noted, *supra*. At the same time, Congress amended Sections 60 and 251 of the Code, by Sections 13(a) and 10(h), both of which call for the ascertainment of percentages of gross income, but did not introduce into those sections any new concept of gross income, nor define gross income as used in those sections as adjusted gross income. Clearly it would not have, for Section 22(n) as enacted in 1944 describes adjusted gross income as gross income less certain deductions provided in Section 23 of the Code.

That gross income is then implicitly defined by the

Code as the sum of adjusted gross income plus certain of the items which may be deducted under Section 23 follows *a fortiori*. It would be impossible for adjusted gross income to constitute gross income for any purpose. That this is logical is clear from the items of income that are included in adjusted gross income. For example, in the case of income from a business, the cost of goods sold is first deducted to arrive at gross profit or gross income. Then are deducted ordinary and necessary business expenses and other deductions allowed by Section 23. The result is net profit, which is carried to page one of the individual tax return as an element in adjusted gross income. It is not yet individual net income, for there are still to be deducted the individual's personal deductions and his exemptions. The fact that the items of income on page one are called adjusted gross income indicates that an adjustment not appearing upon that page has been made, which is in fact the case with respect to the schedules—A through E—contained within the body of the return.

In view of the foregoing, we believe the Tax Court was eminently correct in its determination that in computing the Lindseys' gross income for purposes of Section 107(d), their community shares of gross income from the sole proprietorship should have been included, rather than their community shares of the net profits of that business.

(2) The Tax Court held, erroneously we believe, that since the Langers were joint venturers in the operation of the Figueroa and Clifton Hotels, there need be included in their gross income only their distributive share of the joint venture net income. The

Commissioner conceded below that if partnership returns for the Langers had been filed he would not question the Langers' inclusion only of their share of the net profits from such ventures in their individual gross incomes. He maintained only that failure ~~of~~ to file partnership returns defeated their attempt to contend that the net income from the two ventures was in fact income from joint ventures within the meaning of the Internal Revenue Code. We do not here reiterate that contention.

But we do contend that the Commissioner was wrong below in conceding that if partnership returns had been filed, there would be no questioning of the Langers' inclusion only of the net distributive share of venture profits in gross income. If the concession is of bad law, it is certainly not binding upon this Court. Moreover, despite what may be said with respect to our taking an inconsistent position herein, the position we take is consistent, just as the concession below was inconsistent, with prior administrative policy of the Bureau of Internal Revenue. I. T. 3981, 1942-2 Cum. Bull. 78, holds that in the case of a member of a partnership, gross income for the purposes of Section 251 of the Internal Revenue Code, relating to income from sources within the possessions of the United States, includes the partner's proportionate share of the partnership gross income, not his share of the ordinary net income. Such a position is logically consistent with what we argue herein with respect to the Lindseys. It is our position with respect to them that although only the net income from their business is reported as adjusted gross income on the face of their returns, their

actual gross income for purposes of Section 107(d) includes the gross income of their business. Similarly, with respect to the Langers, only the net distributive share of their joint venture income appears on the face of their returns as adjusted gross income. But to determine their total gross income, we must look to the gross income of their business, whether that business be carried on as a sole proprietorship or as a joint venture. The joint venture is not a tax-paying entity for tax purposes, although properly the Langers as joint venturers should file an information return. An individual's gross income from corporate dividends, e.g., is an entirely different matter from his gross income from a partnership.

It makes no difference that an individual is only required to report on his individual tax return the distributive share of the partnership business net profits; the individual return also calls only for a reporting of the net profit or loss from a business or profession. Schedule C of the 1944 and 1945 returns whereunder the Lindseys showed how the net profit of their sole proprietorship was ascertained is in the nature of an information return. Although contained within Form 1040, it is similar to a partnership information return, nevertheless. Logically, there is no difference between the approach that should be taken toward the income to the individual engaged in the two forms of business, the partnership and the sole proprietorship. And at any rate by definition the distributive share of partnership net income constitutes a portion only of individual net income. Internal Revenue Code, Section 182. The partnership net income is computed similarly

as individual net income, with certain specific exemptions. Section 183. Under the circumstances, we believe the Tax Court erred in making a distinction with respect to the Langers because they were joint venturers, and, as such, recipients of income by way of their net distributive shares of their joint ventures.

Since the Langers should have included in their gross income their proportionate share of the gross income of their joint venture income, it becomes germane to ascertain what the gross income of the ventures was. On their returns for 1944 (Ex. A-1, A-2), the Langers deducted as expenses from gross rentals received on account of the Clifton Hotel the following: taxes, interest on mortgage, depreciation, to the total of $7,813.70. One-half these expenses was allocable to the Langers, one-fourth to each, or $1,953.42 to each. Since these deductions are to be deducted by Section 22(n) from gross income, by reference to Section 23, to ascertain adjusted gross income, the expenses should be included in the Langers' gross income for 1044, for with regard to their rental income gross rents were synonymous with gross income. This, however, was not done on their returns. Instead, taxpayers erroneously argue here that only the net income from the rentals should be included in gross income.

With regard to the Figueroa Hotel, on their returns for 1944 the Langers deducted all expenses of operation. These expenses include both labor costs and overhead. Overhead costs properly include the usual items of rent or occupation cost, insurance, taxes, light, heat, power, depreciation, repairs, supplies, and any other indirect expenses incident to the operation of a hotel.

III Kester, *supra,* 514. It is doubtful, although we do not concede the point, that the Langers' gross receipts from the Figueroa Hotel should be included in gross income. Certain of the expenses of operation are more nearly direct than indirect charges, particularly wages. But many of the charges the Langers set out in their enumeration of operating expenses are items which are deductible from gross income, rather than excludible in arriving at gross income. Into the hopper of overhead expenses, i.e., indirect costs, logically fall such items as advertising expenses, printing and stationery, front office expense, music and entertainment, taxes, repairs, light, heat, and power, for example. The sum of just these expenses, excluding sums which should be allocated out of the accounts labelled "Furniture replacement and repairs" and "carpet replacement and repairs", totals $18,412.61, plus $3,906.84 on account of their rental income from the Clifton Hotel. This figure does not even take into account rental and labor expenses allocable to overhead, rather than to the direct costs of goods sold, i.e., hotel service. It is clear that there is an ample amount which should have been included in the Langers' gross income to more than increase the gross income of each well over the sum of which their back pay must be 15%. If the gross income of each of the Langers exceeded $33,333.33—for $5,000, the share of each in back pay for 1944, is 15% of that sum, then the benefits of Section 107(d) are not available to them. The Tax Court found that Langer's gross income was $30,729.45, his wife's $31,854.43. Clearly, it would take but a slight portion of the sums properly includible in their gross income from the

Figueroa and Clifton Hotels to reach the figure of $33,-333.33. And the record amply shows sufficient items for such a purpose.

CONCLUSION

In view of the foregoing, we believe it has been demonstrated that the Tax Court did not err with respect to the Lindseys, but did err with respect to the Langers.

Respectfully submitted,

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OCTOBER, 1951.

APPENDIX

Internal Revenue Code:

SEC. 107 [As added by Sec. 220(a) of the Revenue Act of 1939, c. 247, 53 Stat. 862 and amended by Sec. 139(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 119(b) of the Revenue Act of 1943, c. 63, 58 Stat. 21]. COMPENSATION FOR SERVICES RENDERED FOR A PERIOD OF THIRTY-SIX MONTHS OR MORE AND BACK PAY.

(d) [As added by Sec. 119(a) of the Revenue Act of 1943, supra] BACK PAY.—

(1) *In General.*—If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 per centum of the gross income of the individual for such year, the part of the tax attributable to the inclusion of such back pay in gross income for the taxable year shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable, as determined under regulations prescribed by the Commissioner with the approval of the Secretary.

(2) *Definition of Back Pay.*—For the purposes of this subsection, 'back pay'' means (A) remuneration, including wages, salaries, retirement pay, and other similar compensation, which is received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which would have been paid prior to the taxable year except for the intervention of one of the following events: (i) bankruptcy or receivership of the employer; (ii) dispute as to the liability of the employer to pay such remuneration,

which is determined after the commencement of court proceedings; (iii) if the employer is the United States, a State, a Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any of the foregoing, lack of funds appropriated to pay such remuneration; or (iv) any other event determined to be similar in nature under regulations prescribed by the Commissioner with the approval of the Secretary; and (B) wages or salaries which are received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which constitute retroactive wage or salary increases ordered, recommended, or approved by any Federal or State agency, and made retroactive to any period prior to the taxable year; and (C) payments which are received or accrued during the taxable year as the result of an alleged violation by an employer of any State or Federal law relating to labor standards or practices, and which are determined under regulations prescribed by the Commissioner with the approval of the Secretary to be attributable to a prior taxable year. Amounts not includible in gross income under this chapter shall not constitute "back pay."

(26 U.S.C. 1946 ed., Sec. 107.)

Treasury Regulations 111, promulated under the Internal Revenue Code:

SEC. 29.107-3 [As added by T. D. 5389, 1944 Cum. Bull. 196]. BACK PAY ATTRIBUTABLE TO PRIOR TAXABLE YEARS.—Section 107(d)(2) defines "back pay" and section 107(d)(1) limits the amount of tax resulting from the inclusion of such back pay in gross income for the year in which it is received

or accrued. Back pay includes compensation for wages, salaries, pensions, and retirement pay received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which would have been paid prior to the taxable year but for the intervention of any one of the following events: (1) bankruptcy or receivership of the employer; (2) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings; (3) if the employer is the United States, a State, a Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any of the foregoing, lack of funds appropriated to pay such remuneration; or (4) any other event determined to be similar in nature under these regulations. As to what constitutes bankruptcy and receivership proceedings see Section 29.274-1.

* * *

An individual must compute his net income for any taxable year to which back pay is attributable, even thought he was not required to make a return for such year. Thus, all amounts properly includible as gross income for any taxable year to which back pay is attributable must be included in the computation.

* * *

The first step in determining whether section 107(d) is applicable is the determination of the percentage which the back pay is of the gross income of the taxpayer for the current taxable year. It must exceed 15 per centum of such gross income. The amount of the tax attributable to such back pay is the difference between the tax for the taxable year computed with the inclusion of such back pay

in gross income and the tax for such taxable year computed without including such back pay in such gross income.

The amount of the tax attributable to such back pay in each taxable year is the difference between the tax for such taxable year computed with the inclusion in gross income of the portion of such back pay attributable to such taxable year and the tax for such taxable year computed without including any part of such back pay in gross income.

The tax for the current taxable year is (1) the tax computed with the inclusion in gross income of the entire back pay received or accrued in the taxable year, or (2) the tax computed without including any such back pay in gross income for the current taxable year, plus the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for each taxable year to which each such portion is respectively attributable, whichever is the smaller.

This may be illustrated by the following example in which the taxpayer makes his returns on the cash receipts and disbursements basis, and in which it is assumed that he is entitled to use and uses for the taxable years 1944 and 1941 the alternative tax provided in Supplement T:

Example. In 1944 a single person with no dependents who who makes his income tax returns on the calendar year basis receives $2,900, which amount constitutes his adjusted gross income. Of this amount, $500 constitutes back pay. His tax for the calendar year 1944 on $2,900 would be $490. On $2,400 ($2,900 minus $500) the tax would be $384. That part of the tax for 1944 attributable to back pay is therefore $106 ($490 minus $384).

Of the back pay, $300 is attributable to the year 1941. During such year he had received $2,000. For such year the amount of the tax on $2,000 is $104. The amount of tax which he would have paid for such year had he included in gross income the portion of back pay attributable to such year would be $130. The increase in the tax for such year would be $26 ($130 minus $104).

The remainder of the back pay, $200, is attributable to the calendar year 1940. During such year his net income was $1,800. For such year the amount of tax, including the defense tax, on $1,800 is $36.08 and the amount of tax, including the defense tax, which he would have paid for such year had he included in gross income the portion of back pay attributable to such year would be $44. The increase in the tax for such year would be $7.92 ($44 minus $36.08). The aggregate of increases in the taxes for the calendar years 1941 and 1940 would be $33.92. The tax for the calendar year 1944 is the smaller of $384 plus (1) $106 or (2) $33.92. Since $33.92 is smaller than $106, the tax for the calendar year 1944 is $417.92 ($384 plus $22.92).

Section 6(d)(3) of the Current Tax Payment Act of 1943, as amended by section 506(b) of the Revenue Act of 1943, provides that section 107 of the Internal Revenue Code shall be applied without regard to subsections (a) and (b) of section 6 of the Current Tax Payment Act of 1943. For example, a taxpayer who had received or accrued compensation including back pay in 1943 determines his income tax, including the victory tax, for such year in the manner provided in section 107 of the Internal Revenue Code before the application of section 6. In the process of determining

such tax, portions of such compensation are attributable to prior years and the limitation upon the increase in the tax for 1943 attributable to such compensation is determined by reference to the tax for the respective years computed upon the portion of such compensation allocable to such years. While all of such compensation is included in gross income for 1942 or 1943, as the case may be, such compensation is attributable to prior years without regard to section 6 of the Current Tax Payment Act of 1943. This may be illustrated by the following example in which the taxpayer makes his returns on the cash receipts and disbursements basis, and in which it is assumed that he is entitled to use and uses for the taxable years 1943, 1942, and 1941 the alternative tax provided in Supplement T.

Example. In 1943 a single person (not the head of a family) who makes his income tax return on a calendar year basis receives $2,200. Of this amount, $600 constitutes back pay. Including the victory tax, his tax liability for 1943 on $2,200 would be $342.10. On $1,600 ($2,200 minus $600) the tax liability would be $216.60. That part of the tax liability for the calendar year 1943 attributable to back pay is therefore $125.50 ($342.10 minus $216.60). Of the back pay, $400 is attributable to the calendar year 1942. During such year he had received $1,000. For the calendar year 1942 the amount of tax liability on $1,000 is $76. The amount of tax liability for such year had he included in gross income the portion of back pay attributable to the calendar year 1942 would be $145. The increase in the tax liability for such year would be $69 ($145 minus $76).

The remainder of the back pay, $200, is attributable to the calendar year 1941. During such year he had received $1,000. For such year the amount of tax on $1,000 is $18, and the amount of tax which he would have paid for such year had he included in gross income the portion of back pay attributable to the year 1941 would be $35. The increase in the tax for such year would be $17 ($35 minus $18). The aggregate of the increases in the taxes for the calendar years 1942 and 1941 would be $86. The tax liability for the calendar year 1943 is the smaller of $216.60 plus (1) $125.50 or (2) $86. Since $86 is smaller than $125.50, the tax liability for the calendar year 1943, prior to the application of section 6 of the Current Tax Payment Act of 1943, is $302.60. For the application of section 6 of the Current Tax Payment Act of 1943, see the regulations thereunder, set forth in Treasury Decision 5300, approved October 1, 1943 (C. B. 1943, 47), and amendments thereto.

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No. 12960

United States
Court of Appeals
for the Ninth Circuit.

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a Corporation,

Appellant,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH and DORIS G. BARUH,

Appellees.

Transcript of Record

**Appeal from the United States District Court,
Northern District of California,
Southern Division.**

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12960

United States
Court of Appeals
for the Ninth Circuit.

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a Corporation,

Appellant,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH and DORIS G. BARUH,

Appellees.

Transcript of Record

**Appeal from the United States District Court,
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

BERT W. LEVIT,
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In the District Court of the United States for the Northern District of California, Southern Division

No. 29584

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a Corporation,

Plaintiff,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, DORIS G. BARUH, and SECURITY INSURANCE COMPANY OF NEW HAVEN, a Corporation,

Defendants.

COMPLAINT FOR DECLARATORY RELIEF

Plaintiff alleges:

I.

The jurisdiction of this Court arises out of the fact that the parties are citizens of different states, and the amount in controversy is in excess of $3000 exclusive of interest and costs; this is a suit brought pursuant to the Federal Declaratory Judgment Act (28 USC 400), in a case of actual controversy between plaintiff and defendants; all as more fully hereinafter appears.

II.

The plaintiff is a corporation incorporated under the laws of the State of Minnesota. The plaintiff is now and for many years past continuously has

been engaged in business as an insurance underwriter in and by authority of the several states of the United States, including the State of California. The principal office of the plaintiff in the State of California is located at San Francisco.

III.

Defendant Security Insurance Company of New Haven is a corporation incorporated under the laws of the State of Connecticut. It is now and for many years past continuously has been engaged in business as an insurance underwriter in and by authority of the several states of the United States, including the State of California. Plaintiff alleges, on information and belief, that the principal office of said defendant in the State of California is located at San Francisco.

IV.

Each of the other defendants is a resident and citizen of the State of California, and not a resident or citizen of the State of Minnesota.

V.

On or about 24 September, 1948, plaintiff did, in California, issue and deliver to defendant Mildred A. Dunwoody its policy of insurance No. 4-24777 (Old California Standard Form Fire Insurance Policy), insuring said defendant against loss by fire for the term of 24 September, 1948, to 24 September, 1949, in the amount of $10,000. Said insurance was apportioned as follows: Item 1. $8,000 on one story composition roof brick building at 223-225 Main Street, Chico, California; and Item 4. $2,000

on the one story brick building with composition roof situated at 227-229 Main Street, Chico, California.

VI.

At all times mentioned in this complaint said premises at 223-229 Main Street, Chico, California, were leased to defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh, and Doris G. Baruh under a written lease for a term of 50 years commencing 1 January, 1944. Paragraph 12 of said lease states:

> "12. Should the whole or any part of any building or buildings at any time standing on the demised premises be partially or totally destroyed by fire after the commencement of the term hereof, the same shall be restored by the Tenant at its own expense without unnecessary delay * * *"

VII.

At all times mentioned in this complaint there was in full force and effect a policy of insurance No. 64539 (Old California Standard Form Fire Insurance Policy) issued by defendant Security Insurance Company insuring defendants Mildred A. Dunwoody, Harold A. Goldman, Myrtle Goldman, Harold F. Baruh, and Doris G. Baruh against loss or damage by fire to said buildings at 223-229 Main Street, Chico, California, in the amount of $36,795.00.

VIII.

The buildings described in said policies of insurance were totally destroyed by fire on 8 April, 1949.

IX.

Defendant Mildred A. Dunwoody has made a demand upon the plaintiff for the sum of $10,000.00, being the full amount of the policy of fire insurance issued by plaintiff to said defendant. It is the position of plaintiff that said defendant has suffered no loss as defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh are required under their lease with defendant Mildred A. Dunwoody to restore the buildings destroyed by said fire without unnecessary delay.

X.

In the event this Court should determine that defendant Mildred A. Dunwoody has suffered a loss within the meaning of the policy issued to her by plaintiff and directs plaintiff to pay said loss within the limits of said policy, plaintiff will then be subrogated to said defendant's rights against defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh under her lease with them. In order to avoid circuity of action and a multiplicity of suits, judgment should then be entered in favor of plaintiff and against defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh for the amount thus found to be due to defendant Mildred A. Dunwoody.

XI.

In the event that this Court should determine that defendant lessees have no duty to restore the buildings destroyed by fire or to pay for the value

of said buildings, the question will then arise as to the apportionment of the loss between plaintiff and defendant Security Insurance Company. Plaintiff is informed and believes that the sound value of said buildings was $33,553.98. The policy issued by plaintiff in the amount of $10,000.00 constitutes 21.37% of the total fire insurance of $46,795.00 covering upon said buildings. Therefore, plaintiff should not be liable for more than 21.37% of the loss, or $7,170.49.

Wherefore, plaintiff prays:

(1) That the Court adjudge that the plaintiff is not liable to defendant Mildred A. Dunwoody in any amount whatsoever;

(2) That should the Court decree that plaintiff is liable to defendant Mildred A. Dunwoody, the Court will determine the amount of said liability and enter judgment against defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Garuh for said amount.

(3) That plaintiff recover its costs of suit herein; and

(4) That plaintiff have such other and further relief as the Court may deem proper.

BERT W. LEVIT,
DAVID C. BOGERT,
LONG & LEVIT,
By /s/ DAVID C. BOGERT,
Attorneys for Plaintiff.

[Endorsed]: Filed March 21, 1950.

[Title of District Court and Cause.]

AMENDED ANSWER OF DEFENDANTS HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH AND DORIS G. BARUH

Now come the defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh, and answering plaintiff's complaint on file herein admit, deny and aver as follows:

I.

Admit the allegations of paragraphs I, II, III, IV and VIII of said complaint.

II.

Admit the allegations of paragraph V of said complaint, and in said behalf these defendants aver that said policy of insurance provides that

> "Subrogation: If this company shall claim that the fire was caused by the act or neglect of any person or corporation, this company shall on payment of the loss be subrogated to the extent of such payment to all right of recovery by the insured for the loss resulting therefrom and such right shall be assigned to this company by the insured on receiving such payment,"

and further,

> "Subrogation Waiver Clause: This insurance shall not be prejudiced by agreement made by the named insured releasing or waiving this company's right of subrogation against third

parties responsible for the loss under the following circumstances only:

"(I) If made before loss has occurred, such agreement may run in favor of any third party,"

and does not confer upon said plaintiff any right of subrogation with respect to any contract entered into by the insured with any third party; and, as these defendants are informed and believe and therefore aver, said policy does not contain a depreciation insurance endorsement and the coverage of said policy does not include depreciation.

III.

Admit the allegations of paragraph VI of said complaint save to the following extent: That the allegation respecting paragraph 12 of said lease constitutes but a portion of said paragraph and that said paragraph of said lease is as follows:

Should the whole or any part of any building or buildings at any time standing on the demised premises be partially or totally destroyed by fire after the commencement of the term hereof, the same shall be restored by the Tenant at its own expense without unnecessary delay. The Tenant covenants and agrees that it, the Tenant, shall at all times during the term hereof and at its own expense keep any and all buildings or improvements now upon or hereafter constructed or placed upon said premises, insured against loss or damage by fire in an amount equal to eighty (80) per cent of the full

insurable value thereof above the foundation walls. All such policies of insurance shall be payable to the Landlords and Tenant as their interest may appear, and shall be written by solvent fire insurance companies authorized to do business in the State of California. Such Policies of insurance shall be held by the Tenant, and the Landlords shall be furnished with the usual certificates from insurance companies showing the existence of such policies. In case of loss, the Tenant is hereby authorized to adjust the loss and execute proofs thereof in the names of both the Tenant and the Landlords. So long as the Tenant shall comply with the provisions of this lease respecting fire insurance, the Landlords covenant and agree not to carry or permit to be carried during the term or any extension or renewal thereof, any additional or other fire insurance covering any interest in the demised premises without the knowledge and consent of the Tenant, but if the Landlords shall desire to carry additional insurance and request the tenant to consent thereto, its consent shall not be unreasonably withheld when any such insurance shall not jeopardize or decrease the amount recoverable under the insurance or self insurance herein provided to be carried by the Tenant. The Tenant shall, upon the request of the Landlords furnish the Landlords evidence of is compliance with these provisions and of the fact of coverage adequate in the premises.

Notwithstanding anything else herein con-

> tained to the contrary, if the premises or a portion thereof be damaged by fire, upon the payment of the insurance by the insurance company of the loss to the parties hereto as their interests may appear, all of such payment may be used by the Landlord for the purpose of restoring the portion damaged if the Landlord desires,

and further aver that said defendant Mildred A. Dunwoody sought and received the consent of these defendants to carry insurance upon the said building or buildings in addition to the insurance thereon theretofore effected by these defendants and then in effect and in effect at the time of said fire, and that pursuant to said consent said defendant Dunwoody insured her interest as owner of said property with said plaintiff and which insurance was covered and evidenced by plaintiff's said policy No. 4-24777.

IV.

With respect to paragraph VII of said complaint, these defendants deny the allegations thereof save that at the time of said fire there was in full force and effect a policy of fire insurance No. 64539 issued by defendant Security Insurance Company covering said buildings in the amount of $36,795.00, and in said behalf these defendants aver that the insured named in said policy were the defendants Harold F. Baruh and Harold Goldman and/or M. Dunwoody and that loss thereunder was to be adjusted with and payable to said Harold F. Baruh and Harold Goldman; that said policy contained a de-

preciation insurance endorsement and thereby insured the replacement cost of said buildings without deduction for depreciation.

V.

With respect to paragraph IX of said complaint, these defendants deny that said defendant Dunwoody has suffered no loss under the said policy of fire insurance issued by said plaintiff to said defendant, whether for the reason set forth in said paragraph IX or for any other reason. These defendants aver that the construction of a building or buildings in replacement of the said buildings destroyed by said fire has not been undertaken as yet, and that the same has been delayed by these defendants with the consent and approval of said defendant Dunwoody pending, initially, the efforts of these defendants to procure recognition by Montgomery Ward & Co., Incorporated, of a sublease dated February 25, 1946, from these defendants to it of the said property, under which these defendants agreed to construct upon the said realty a new building for said Montgomery Ward & Co., Incorporated, and to pay the cost thereof up to the sum of $327,500; that these efforts have proved unsuccessful and that within the last several months these defendants have given, and presently are giving, their attention to the procurement of a tenant of substantial worth for said property, carrying with it the construction thereon by these defendants of a building suitable for the conduct thereon of the business of such tenant, and that the cost of the

construction of such building or, in the event of inability to procure such tenant, the cost of the construction on said property of one or more buildings to meet the requirements of the ordinary tenant or tenants will, as these defendants are informed and believe and therefore aver, substantially exceed the aggregate of the gross amount of the insurance provided for by said policy of said Security Insurance Company, namely, $36,795.00, and by said policy of said plaintiff, namely, $10,000.00.

VI.

Respecting paragraph X, these defendants deny that said plaintiff will, in the instance specified in said paragraph, be subrogated to the defendant Dunwoody's rights against these defendants or any of them under the defendant Dunwoody's lease with these defendants or otherwise or at all, and further deny that at any time since the occurrence of said fire there was or presently is or hereafter will be any amount due from these defendants or any of them to said defendant Dunwoody under the aforesaid paragraph 12 of said lease, and further deny that for any reason whatsoever any judgment should be entered in favor of plaintiff and against these defendants or any of them for any amount.

VII.

Respecting paragraph II of said complaint, these defendants deny that there is any right of apportionment of the said loss between said plaintiff and defendant Security Insurance Company, and, upon information and belief, further deny that the sound

value of said buildings was at the time of said loss the sum of $33,553.98, and in said behalf these defendants aver, upon information and belief, that the sound value of said buildings was at the time of said loss not less than the sum of $46,975.57 without depreciation and was not less than the sum of $35,-231.68 after deduction of depreciation. These defendants aver that said Security Insurance Company did accept the immediately above-averred sound value before and after depreciation and did find that there was a total loss, after the deduction of depreciation, under its policy and the said policy of plaintiff, and did pay unto the defendants Harold F. Baruh and Harold A. Goldman, upon the basis of a total loss, the sum of $25,051.11 as the proportion of the gross amount, after deduction of depreciation, of the policy issued by said Security Insurance Company, and did and does withhold the balance, or the sum of $11,743.89, of said gross amount, which balance constitutes the depreciation arrived at by it, and did, and presently does, recognize its liability to said defendants Harold F. Baruh and Harold A. Goldman to pay said amount of $11,743.89 upon the replacement of the destroyed buildings, which course of withholding and time of payment are in conformity with the provisions of the said depreciation insurance endorsement. That, as these defendants are informed and believe and therefore aver, the percentage of said depreciation was agreed to by said plaintiff and said Security Insurance Company in or about the month of June, 1949, and that the agreed percentage was adhered

to by said Security Insurance Company in the aforesaid determination by it of the said amount of depreciation.

These defendants are informed and believe and therefore aver that defendant Dunwoody did, within the time provided for by the said policy issued to her by said plaintiff, render to said plaintiff an amended proof of loss, signed and sworn to by her, setting forth therein the information called for by said policy and claiming therein a total loss under said policy.

As a Further, Separate and Second Defense to plaintiff's complaint on file herein these defendants aver as follows:

I.

That the premises at 223-229 Main Street, Chico, California, were at all times mentioned in said complaint and now are, leased by defendant Mildred A. Dunwoody to these defendants under a written lease for a term of fifty (50) years commencing January 1, 1944. That paragraph 12 of said lease is set forth in paragraph III of the first defense herein and these defendants re-aver and incorporate the same herein, by reference thereto.

II.

That in April, 1946, defendant Mildred A. Dunwoody and these defendants entered into an agreement in writing, a copy of which is hereunto annexed, marked Exhibit "A," and incorporated

herein by reference as though herein fully at length set forth.

III.

That in April, 1946, defendant Mildred A. Dunwoody and defendants Harold F. Baruh and Harold A. Goldman entered into an agreement in writing, a copy of which is hereunto annexed, marked Exhibit "B," and incorporated herein by reference as though herein fully at length set forth.

IV.

That on the 29th day of April, 1946, and within six months from the date of the execution and delivery of the aforesaid agreement marked Exhibit "A," these defendants, as "Landlord," and Montgomery Ward & Co., Incorporated, as "Tenant," entered into a sublease dated the 25th day of February, 1946, of the premises referred to in paragraph I hereof for a term in excess of thirty (30) years commencing on the 1st day of March, 1946.

V.

That as provided in said agreement marked Exhibit "A," upon the execution and delivery thereof, said paragraph 12 of the aforesaid lease became of no force and effect whatsoever.

VI.

That by reason of said agreement marked Exhibit "A," these defendants are not required under their aforesaid lease with defendant Mildred A. Dunwoody, or at all, to restore the buildings referred

to in paragraph I hereof, which were totally destroyed by fire on April 8, 1949.

Wherefore, these defendants pray that this Court do render its judgment that plaintiff is not entitled to any relief under its said complaint; that plaintiff's said complaint be dismissed and that this Court award these defendants their costs and disbursements herein and such other and further relief as this Court may deem meet in the premises.

OSCAR SAMUELS and

TEVIS JACOBS,

By /s/ OSCAR SAMUELS,

Attorneys for Defendants Harold A. Goldman, Mrytle Goldman, Harold F. Baruh and Doris G. Baruh.

Consent is hereby given to the filing of the foregoing amended answer and service of a copy thereof is hereby admitted this day of November, 1950.

BERT W. LEVIT,

DAVID C. BOGERT,

LONG & LEVIT,

By /s/ DAVID C. BOGERT,

Attorneys for Plaintiff.

EXHIBIT "A"

This Supplemental Agreement, made as of the 16th day of April, 1946, between Mildred Dunwoody, an unmarried person, of Chico, California, hereinafter called the Landlord, and H. A. Goldman and Myrtle Goldman, his wife, and H. F. Baruh and Doris G. Baruh, his wife, of Alameda County, California, hereinafter called the Tenant, amending that certain lease dated the First (1st day of November, 1943, by and between the said Mildred Dunwoody, her heirs and assigns, therein called the Landlord, and The Grand Rapids Furniture Company, its heirs and assigns, therein called the Tenants, which lease dated November 1, 1943, was assigned by The Grand Rapids Furniture Company, Harry Polse and Reva Polse and Mary Louise Unger to H. A. Goldman and H. F. Baruh by instrument dated April 3, 1945, and which lease covers certain real property situated in the City of Chico, County of Butte and State of California, described as follows:

> Being a portion of Lots Two (2) and Three (3) in Block Nine (9) of the City of Chico, according to the Official Map thereof, filed and of record in the office of the Recorder of the County of Butte, State of California, and more particularly described as follows, to wit:
>
> Commencing at a point on the Westerly side of Wall Street, distant Ninety-nine (99) feet in a Southerly direction from the northeasterly corner of Lot One (1) of said Block Nine (9); thence at right angles westerly and parallel with

Second Street, One Hundred and Thirty-two (132) feet to the Westerly line of said Lot Two (2); thence at right angles Southerly along the Westerly line of said Lots Two (2) and Three (3), Sixty-three (63) feet to a point distant Thirty-six (36) feet in a Northerly direction from the Southwesterly corner of said lot Three (3); thence at right angles Easterly and parallel with the Southerly line of said Lot Three (3), One Hundred and Thirty-two (132) feet to the Westerly line of Wall Street; thence Northerly along the Westerly line of Wall Street, Sixty-three (63) feet to the place of beginning.

A portion of Lot Six (6) in Block Nine (9) of the City (formerly town) of Chico, according to the official map thereof, filed in the office of the Recorder of the County of Butte, State of California, and more particularly described as follows, to wit:

Commencing at a point on the northeasterly line of Main Street, 17 feet southeasterly from the northwest corner of said Lot 6; and running thence southeasterly along the line of Main Street, 24½ feet; thence northeasterly at a right angle with Main Street, 132 feet to the northeasterly line of said Lot 6; thence northwesterly along the easterly line of said Lot 6, 24½ feet; thence southwesterly and parallel with Third Street, 132 feet to the point of beginning.

Excepting Therefrom the following, to wit:

Commencing at a point on the northeasterly

line of Main Street, 24½ feet northwesterly from the southwest corner of said Lot 6; thence northwesterly along said line of Main Street, 9 feet; thence northeasterly at a right angle with Main Street and parallel with Third Street, 132 feet to the northeasterly line of said Lot 6; thence southeasterly along said line of Lot 6, 9 feet; thence southwesterly and parallel with Third Street, 132 feet to the point of beginning.

A part of Lots Six (6) and Seven (7) of Block Nine (9) of the City (formerly Town) of Chico, according to the official map thereof, filed in the office of the Recorder of the County of Butte, State of California, and more particularly described as follows:

Commencing at a point on the Easterly line of Main Street, distant Seventeen (17) feet, Southerly from the Northerly line of Lot Six (6) said Block; thence Easterly and parallel with Second Street, One Hundred and Thirty-two (132) feet; thence at a right angle Northerly and parallel with Main Street, Fifty (50) feet; thence at a right angle Westerly and parallel with Second Street, One Hundred Thirty-two (132) feet to the Easterly line of Main Street; thence Southwesterly along the Easterly line of Main Street, Fifty (50) feet to the place of beginning.

Witnesseth:

That whereas the said H. A. Goldman, Myrtle

Goldman, H. F. Baruh and Doris G. Baruh, contemplate leasing the above-described premises for a term of twenty-five (25) years or upwards to Montgomery Ward & Co., Incorporated, an Illinois Corporation, having general offices at 619 West Chicago Avenue, Chicago, Illinois, and

Whereas, the said Montgomery Ward & Co., Incorporated, expects to make extensive improvements upon the premises demised by said lease dated November 1, 1943, and desires to have uninterrupted possession of such premises for the full term of its lease and during any extension or extensions of the terms thereof, and

Whereas, the said Mildred Dunwoody, H. A. Goldman, Myrtle Goldman, H. F. Baruh and Doris G. Baruh are willing and agreeable to allow the said Montgomery Ward & Co., Incorporated, to have uninterrupted possession of the premises hereinabove described during the full term and any extension or extensions of the term of any lease of such premises which the said Montgomery Ward & Co., Incorporated, may enter into with the said H. A. Goldman, Myrtle Goldman, H. F. Baruh and Doris G. Baruh.

Now, Therefore, in consideration of the said Montgomery Ward & Co., Incorporated, entering into a lease for a term of twenty-five (25) years or upwards covering the premises hereinabove described with the said H. A. Goldman, Myrtle Goldman, H. F. Baruh and Doris G. Baruh, and for the further consideration of the sum of Ten Dollars ($10.00) and other good and valuable considerations

paid by the said Montgomery Ward & Co., Incorporated, to the said Mildred Dunwoody, the receipt and sufficiency of which is hereby acknowledged, the parties hereto agree as follows:

1. Effective as of the date of the complete execution and delivery of this agreement by the parties hereto, the following sections and paragraphs of said lease dated November 1, 1943, shall, upon the stipulation and conditions set forth in Section 2 hereof be of no force and effect whatsoever, to wit: Section 4, after the date the said Montgomery Ward & Co., Incorporated, is required to pay taxes under the provisions of any lease it enters into with the said H. A. Goldman, Myrtle Goldman, H. F. Baruh and Doris G. Baruh, covering the above-described premises; Sections 5 and 6, the paragraph attached to page 6, Sections 7, 8, 9, 11 and 12, the paragraph attached to page 9, Sections 13 and 14 and paragraph (a) under Section 14, the paragraph attached to page 10, Sections 15, 16 and 17, paragraphs (a) and (b) under Section 18 and Sections 20, 21, 22 and 26.

2. The parties hereto agree that if the said Montgomery Ward & Co., Incorporated, enters into a lease of the hereinabove-described premises with the said H. A. Goldman, Myrtle Goldman, H. F. Baruh and Doris G. Baruh for a term of twenty-five (25) years or upwards, within six (6) months after the date hereof, and that so long as any such lease shall not be terminated, all sections and paragraphs mentioned in Section 1 hereof shall be ineffective and unenforcible by any of the parties hereto.

3. It is agreed that all permanent additions or improvements placed upon the hereinabove-described premises by the said Montgomery Ward & Co., Incorporated, shall belong to the said Mildred Dunwoody, her heirs, legal representatives and assigns subject to said lease dated November 1, 1943, and to any lease of such premises which the said Montgomery Ward & Co., Incorporated, may enter into as aforesaid.

4. Except as modified hereby said lease dated November 1, 1943, shall remain in effect. All of the covenants of said lease as hereby amended shall be binding upon and shall inure to the benefit of the parties hereto, their respective heirs, legal representatives and assigns.

In Witness Whereof, the parties hereto have caused this agreement to be duly executed in duplicate, under seal, as of the day and year first above written.

[Seal] MILDRED DUNWOODY,
MILDRED DUNWOODY.

Witnesses:

JEAN FULTON,
DORIS BROOMHEAD,

[Seal] H. A. GOLDMAN,
H. A. GOLDMAN,

[Seal] MYRTLE GOLDMAN,
MYRTLE GOLDMAN,

[Seal] H. F. BARUH,
H. F. BARUH,

[Seal] DORIS G. BARUH,
DORIS G. BARUH.

Witnesses:

GRACE McGOLDRICK,
JANE ANDERSON,

L. C. DAVIS, JR.,
JOSEPH TAUSSIG,

State of California,
County of Butte—ss.

On this 29th day of April, A.D. 1946, before me, Jerome D. Peters, a Notary Public in and for said county and state, residing therein, duly commissioned and sworn, personally appeared Mildred Dunwoody, an unmarried person, known to me to be the person whose name is subscribed to the within instrument, and acknowledged to me that she executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] JEROME D. PETERS,
Notary Public, Butte County,
California.

My commission expires: 4-16-47.

State of California,
County of Alameda—ss.

On this 16th day of April, A.D. 1946, before me, Mary Parkinson, a Notary Public in and for said county and state, residing therein, duly commissioned and sworn, personally appeared H. A. Goldman and Myrtle Goldman, his wife, and H. F. Baruh and Doris G. Baruh, his wife, known to me to be the persons whose names are subscribed to the within instrument, and acknowledged to me that they executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] MARY PARKINSON,
Notary Public, Alameda
County, California.

My commission expires: Jan. 21, 1950.

EXHIBIT "B"

Agreement

This Agreement entered into this 23rd day of April, 1946, by and between Mildred Dunwoody, the Party of the First Part, and Harold Baruh, Harold Goldman, Their Heirs, Assigns, and Executors, being the Party of the Second Part.

The Party of the First Part does hereby agree to execute a supplemental agreement together with that certain lease by and between the Parties of the

Second Part and the Montgomery Ward Company of Chicago, Illinois.

It is understood and agreed by and between both parties that the signing of said supplemental agreement and lease does not in any way relieve the parties of the Second Part of any of the obligations and conditions undertaken by said party of the Second Part in the original lease by and between the Party of the First Part and the Grand Rapids Furniture Company, dated November 1st, 1943, which was later assigned to the Party of the Second Part by the Grand Rapids Furniture Company and Harry Polse and Reva Polse.

For and in consideration of the signing of the supplemental agreement, and the lease hereinabove mentioned, the Parties of the Second Part do hereby agree to increase the monthly rental as stipulated in the original lease Twenty-five Dollars ($25.00) per month during the life of said lease.

HAROLD GOLDMAN,

HAROLD BARUH,

MILDRED DUNWOODY.

State of California,
County of Butte—ss.

On this 29th day of April, in the year One Thousand Nine Hundred and Forty-six, before me, Jerome D. Peters, a Notary Public in and for the County of Butte, personally appeared Mildred Dunwoody, an unmarried woman, known to me to be the same person whose name is subscribed to the

within instrument, and she duly acknowledged that she executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my Official Seal, at my office, in the County of Butte, the day and year in this certificate first above written.

[Seal] JEROME D. PETERS,
Notary Public in and for the County of Butte, State of California.

[Endorsed]: Filed November 30, 1950.

[Title of District Court and Cause.]

AMENDED ANSWER AND CROSS-COMPLAINT OF DEFENDANT AND CROSS-COMPLAINANT MILDRED A. DUNWOODY

Comes Now the defendant Mildred A. Dunwoody and amends her answer to plaintiff's complaint on file herein, and admits, denies and avers as follows:

I.

Admits the allegations contained in Paragraphs I, II, III, IV, VII and VIII.

II.

Admits the allegations of Paragraph V, and avers that said policy of insurance provides that

"Subrogation: If this company shall claim that the fire was caused by the act or neglect of

any person or corporation, this company shall on payment of the loss be subrogated to the extent of such payment to all right of recovery by the insured for the loss resulting therefrom and such right shall be assigned to this company by the insured on re-receiving such payment."

and further,

"Subrogation Waiver Clause: This insurance shall not be prejudiced by agreement made by the named insured releasing or waiving this company's right of subrogation against third parties responsible for the loss under the following circumstances only:

"(I) If made before loss has occurred, such agreement may run in favor of any third party,"

and does not confer upon said plaintiff any right of subrogation with respect to any contract entered into by the insured with any third party; and, as this defendant is informed and believes and therefore avers, said policy does not contain a depreciation insurance endorsement and the coverage of said policy does not include depreciation.

III.

Admits the allegations of Paragraph VI of said complaint, save to the following extent: That the allegation respecting Paragraph 12 of said lease constitutes but a portion of said paragraph and that said paragraph of said lease is as follows:

"Should the whole or any part of any building or buildings at any time standing on the

demised premises be partially or totally destroyed by fire after the commencement of the term hereof, the same shall be restored by the Tenant at its own expense without unnecessary delay. The Tenant covenants and agrees that it, the Tenant, shall at all times during the term hereof and at its own expense keep any and all buildings or improvements now upon or hereafter constructed or placed upon said premises, insured against loss or damage by fire in an amount equal to eighty (80) per cent of the full insurable value thereof above the foundation walls. All such policies of insurance shall be payable to the landlords and Tenant as their interest may appear, and shall be written by solvent fire insurance companies authorized to do business in the State of California. Such Policies of insurance shall be held by the Tenant, and the Landlords shall be furnished with the usual certificates from insurance companies showing the existence of such policies. In case of loss, the Tenant is hereby authorized to adjust the loss and execute the proofs thereof in the names of both the Tenant and the Landlords. So long as the Tenant shall comply with the provisions of this lease respecting fire insurance, the Landlords covenant and agree not to carry or permit to be carried during the term of any extension of renewal thereof, any additional or other fire insurance covering any interest in the demised premises without the

knowledge and consent of the Tenant, but if the Landlords shall desire to carry additional insurance and request the tenant to consent thereto, its consent shall not be unreasonably withheld when any such insurance shall not jeopardize or decrease the amount recoverable under the insurance or self insurance herein provided to be carried by the Tenant. The Tenant shall, upon the request of the Landlords furnish the Landlords evidence of its compliance with these provisions and of the fact of coverage adequate in the premises.

"Notwithstanding anything else herein contained to the contrary, if the premises or a portion thereof be damaged by fire, upon the payment of insurance by the insurance company of the loss to the parties hereto as their interests may appear, all of such payment may be used by the Landlord for the purpose of restoring the portion damaged if the Landlord desires,"

and further avers that this defendant Mildred A. Dunwoody sought and received the consent of the defendants, Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh, to carry insurance upon the said building or buildings; and that pursuant to said consent this defendant Mildred A. Dunwoody insured her interest as owner of said property with said plaintiff and which insurance was covered and evidenced by plaintiff's said policy No. 4-24777.

IV.

Admits the first sentence of Paragraph IX; denies the second sentence.

V.

Denies Paragraph X.

VI.

Answering Paragraph XI, answering defendant denies that there is any right of apportionment of the said loss between plaintiff and defendant Security Insurance Company, and denies that the sound value of said buildings was at the time of said loss only the sum of $33,533.98 and avers it was upwards of $50,000.00.

VII.

Alleges that answering defendant did, within the time provided for by the said policy issued to her by plaintiff, and in pursuance of plaintiff's request, render to plaintiff an amended proof of loss, signed and sworn to by her, setting forth therein the information called for by said policy and claimed a total loss in the sum of $10,000.00, which was accepted as adequate proof under the said policy by plaintiff; that neither the whole or any part of said sum of $10,000.00 has been paid.

Amended Cross-Complaint Against Plaintiff Hardware Mutual Insurance Company of Minnesota, a corporation.

Comes Now the defendant Mildred A. Dunwoody and cross-complains against plaintiff Hardware

Mutual Insurance Company of Minnesota, a corporation, and for cause of cross-complaint alleges as follows, to wit:

I.

Defendant and cross-complainant Mildred A. Dunwoody adopts the allegations contained in Paragraphs II, V and VIII of plaintiff's complaint and that portion of Paragraph IX which reads:

> "Defendant Mildred A. Dunwoody has made a demand upon plaintiff for the sum of $10,000.00, being the full amount of the policy of fire insurance issued by plaintiff to said defendant;"

denies the remaining portion of Paragraph IX.

II.

That the policy of insurance referred to in Paragraph V as having been issued to the defendant and cross-complainant was insurance upon her owner's interest in the property described in the policy, namely, the two buildings referred to in Paragraph V of plaintiff's complaint; that upon the 8th day of April, 1949, the said two buildings referred to in Paragraph V of plaintiff's complaint were completely destroyed by fire; that the value of said buildings was in excess of the amount of fire insurance carried against their loss, namely, $10,000.00.

III.

That defendant and cross-complainant has performed all the terms and conditions of the said policy of insurance referred to in Paragraph V of

plaintiff's complaint and the full amount thereof, namely, $10,000.00 is now due, owing and unpaid from plaintiff and cross-defendant to defendant and cross-complainant.

Wherefore, defendant and cross-complainant prays judgment as follows:

1. That plaintiff take nothing by its said complaint.

2. That cross-complainant Mildred A. Dunwoody have judgment under her cross-complaint against the plaintiff Hardware Mutual Insurance Company of Minnesota, a corporation, in the sum of $10,000.00, the face value of the said insurance policy, with interest at the rate of 7% per annum from January 21st, 1950, and for her costs of suit.

3. For such other relief as may be meet and proper in equity.

Dated: November . ., 1950.

/s/ PETERS AND PETERS,
Attorneys for Defendant and Cross-Complainant,
Mildred A. Dunwoody.

State of California,
County of Butte—ss.

Mildred A. Dunwoody, being first duly sworn, deposes and says:

That she is one of the defendants in the above-entitled action; that she has read the foregoing Amended Answer and Cross-Complaint of Defend-

ant and Cross-Complainant Mildred A. Dunwoody and knows the contents thereof; that the same is true of her own knowledge except as to those matters therein contained on her information or belief and as to those matters, she believes it to be true.

/s/ MILDRED A. DUNWOODY.

Subscribed and sworn to before me this .... day of November, 1950.

[Seal] /s/ JEROME D. PETERS, JR.,
Notary Public in and for the County of Butte, State of California.

Affidavit of Service by Mail attached.

[Endorsed]: Filed November 27, 1950.

[Title of District Court and Cause.]

ANSWER TO CROSS-COMPLAINT

For answer to the cross-complaint of Mildred A. Dunwoody, defendant and cross-complainant in the above-entitled cause, plaintiff and cross-defendant Hardware Mutual Insurance Co. of Minnesota admits, denies and alleges as follows:

I.

Plaintiff and cross-defendant denies each and every allegation in paragraph II of said cross-complaint.

Wherefore, plaintiff and cross-defendant prays

that defendant and cross-complainant Mildred A. Dunwoody take nothing by her cross-complaint herein, and that judgment be entered in favor of plaintiff and cross-defendant and against said defendant and cross-complainant and against the other defendants as prayed in plaintiff's complaint on file herein.

BERT W. LEVIT,

DAVID C. BOGERT,

LONG & LEVIT,

By /s/ DAVID C. BOGERT,

Attorneys for Plaintiff and Cross-Defendant.

Affidavit of Service by Mail attached.

[Endorsed]: Filed July 1, 1950.

District Court of the United States
Northern District of California
Southern Division

At a Stated Term of the Southern Division of the United States District Court for the Northern District of California, held at the Court Room thereof, in the City and County of San Francisco, on Tuesday, the 20th day of February, in the year of our Lord one thousand nine hundred and fifty-one.

Present: The Honorable Michael J. Roche,
District Judge.

[Title of Cause.]

MINUTE ORDER

This case came on regularly this day for trial before the Court sitting without a jury. David C. Bogert, Esq. appeared on behalf of plaintiff; Jerome D. Peters, Esq. was present for defendant Dunwoody, and Robert Sills, Esq. appeared on behalf of H. F. Baruh and wife and H. A. Goldman and wife. Upon motion of Mr. Bogert, it is Ordered that the answer to cross-complaint stand as answer to the amended cross-complaint of Mildred Dunwoody. Opening statements were made by respective counsel. The plaintiff introduced into evidence, filed in record, certain exhibits which were to be marked Plaintiff's Exhibits Nos. 1 and 2. Harold F. Baruh and Mildred Dunwoody were sworn and testified as adverse witnesses on behalf of plaintiff. Defendant introduced into evidence certain exhibits which were marked as Defendant's Exhibits "A" and

"B." After arguments by respective counsel, it is Ordered that judgment be and the same is hereby entered for the defendant and against the plaintiff. Further Ordered that findings of fact and conclusions of law and judgment be prepared and that the matter be continued to March 9, 1951, for settlement of findings.

[Title of District Court and Cause.]

STIPULATION TO ADMIT CERTAIN FACTS

The parties to the above-entitled action agree upon the following statement of a portion of the facts in the above-entitled action and submit the same to the Court as true.

I.

The jurisdiction of this Court arises out of the fact that the parties are citizens of different states and the amount in controversy is in excess of $3,000 exclusive of interest and costs. This is a suit brought pursuant to the Federal Declaratory Judgment Act (28 USC 400), in a case of actual controversy between plaintiff and defendants.

II.

The plaintiff is a corporation incorporated under the laws of the State of Minnesota. The plaintiff is now and for many years past continuously has been engaged in business as an insurance underwriter in and by authority of the several states of the United

States, including the State of California. The principal office of the plaintiff in the State of California is located in San Francisco.

III.

Each of the defendants is a resident and citizen of the State of California, and not a resident or citizen of the State of Minnesota.

IV.

On or about 24 September, 1948, plaintiff did, in California, issue and deliver to defendant Mildred A. Dunwoody its policy of insurance No. 4-24777 (Old California Standard Form Fire Insurance Policy) insuring said defendant against loss by fire for the term of 24 September, 1948, to 24 September, 1949, in the amount of $10,000. Said insurance was apportioned as follows: Item 1. $8,000 on one story composition roof brick building at 223-225 Main Street, Chico, California; and Item 4. $2,000 on the one story brick building with composition roof situated at 227-229 Main Street, Chico, California.

The main body of the policy contains a paragraph relating to subrogation reading as follows:

> "Subrogation. If this company shall claim that the fire was caused by the act or neglect of any person or corporation, this company shall, on payment of the loss be subrogated to the extent of such payment to all right of recovery by the insured for the loss resulting therefrom, and such right shall be assigned to this company by the insured on receiving such payment."

An endorsement attached to said policy contains a paragraph relating to waiver of subrogation reading, in part, as follows:

"19. Subrogation Waiver Clause: This insurance shall not be prejudiced by agreement made by the named Insured releasing or waiving this Company's right of subrogation against third parties responsible for the loss, under the following circumstances only:

(I) If made before loss has occurred, such agreement may run in favor of any third party; . . .

(III) Whether Made Before or After Loss Has Occurred, Such Agreement Must Include a Release or Waiver of the Entire Right of Recovery of the Named Insured Against Such Third Party."

A true and correct copy of said policy of insurance and of the endorsements attached thereto is attached hereto, marked Exhibit "A," and made a part hereof. Said policy was obtained by defendant Mildred A. Dunwoody with the consent of the other defendants. Said policy does not contain a depreciation insurance endorsement and the coverage of said policy does not include depreciation.

V.

At all times mentioned in this stipulation the premises at 223-229 Main Street, Chico, California, were and now are leased to defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh, and Doris G. Baruh under a written lease for a term of

fifty years, commencing 1 January, 1944. Paragraph 12 of said lease reads as follows:

> "12. Should the whole or any part of any building or buildings at any time standing on the demised premises be partially or totally destroyed by fire after the commencement of the term hereof, the same shall be restored by the Tenant at its own expense without unnecessary delay. The Tenant covenants and agrees that it, the Tenant, shall at all times during the term hereof and at its own expense keep any and all buildings or improvements now upon or hereafter constructed or placed upon said premises, insured against loss or damage by fire in an amount equal to eighty (80) per cent of the full insurable value thereof above the foundation walls. All such policies of insurance shall be payable to the Landlords and Tenant as their interest may appear, and shall be written by solvent fire insurance companies authorized to do business in the State of California. Such Policies of insurance shall be held by the Tenant, and the Landlords shall be furnished with the usual certificates from insurance companies showing the existence of such policies. In case of loss, the Tenant is hereby authorized to adjust the loss and execute proofs thereof in the names of both the Tenant and the Landlords. So long as the Tenant shall comply with the provisions of this lease respecting fire insurance, the Landlords covenant and agree not to carry or permit to be carried during the term

of any extension of renewal thereof, any additional or other fire insurance covering any interest in the demised premises without the knowledge and consent of the Tenant, but if the Landlords shall desire to carry additional insurance and request the tenant to consent thereto, its consent shall not be unreasonably withheld when any such insurance shall not jeopardize or decrease the amount recoverable under the insurance or self insurance herein provided to be carried by the Tenant. The Tenant shall, upon the request of the Landlords furnish the Landlords evidence of its compliance with these provisions and of the fact of coverage adequate in the premises.

Notwithstanding anything else herein contained to the contrary, if the premises or a portion thereof be damaged by fire, upon the payment of the insurance by the insurance company of the loss to the parties hereto as their interests may appear, all of such payment may be used by the Landlord for the purpose of restoring the portion damaged if the Landlord desires."

VI.

The property described in said policy of insurance was totally destroyed by fire on 8 April, 1949. Said fire was due to causes unknown.

VII.

At the time of said fire there was in full force and effect another policy of fire insurance No.

64539 issued by the Security Insurance Company of New Haven, covering the buildings at 223-225 Main Street, Chico, California, and 227-229 Main Street, Chico, California, in the amount of $36,795.00. The insured named in said policy were the defendants Harold F. Baruh and Harold Goldman and/or M. Dunwoody. Loss under said policy was to be adjusted with and payable to said Harold F. Baruh and Harold Goldman. Said policy contained a depreciation insurance endorsement and thereby insured the replacement cost of said buildings without deduction for depreciation.

VIII.

Defendant Mildred A. Dunwoody has made a demand upon the plaintiff for the sum of $10,000, being the full amount of the policy of fire insurance issued by plaintiff to said defendant.

IX.

The construction of a building or buildings in replacement of the said buildings destroyed by said fire has not been undertaken as yet. Said construction has been delayed by the defendants Harold A. Goldman, Mytrle Goldman, Harold F. Baruh, and Doris G. Baruh with the consent and approval of the defendant Mildred A. Dunwoody. Said consent was given after the said fire and in or about the month of June, 1950.

X.

The parties hereto have not agreed as to the sound value at the time of the fire of the buildings described in said policies of insurance.

XI.

The defendant Mildred A. Dunwoody, as Landlord, and defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh, and Doris G. Baruh, as Tenant, entered into a certain supplemental agreement, a true copy of which is attached hereto, marked Exhibit "B" and made a part hereof.

XII.

The defendant Mildred A. Dunwoody, as Party of the First Part, and Harold Baruh and Harold Goldman, Parties of the Second Part, entered into a certain supplemental agreement, a true copy of which is attached hereto, marked Exhibit "C" and made a part hereof.

XIII.

Within six months after the date and the execution and delivery of the agreement referred to hereinabove in paragraph XI, Montgomery Ward & Co., Incorporated, as Tenant, entered into a sublease with the defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh, and Doris G. Baruh, as Landlord, of the premises referred to hereinabove in Paragraph V for a term in excess of twenty-five years, commencing 1 March, 1946. Notarial certifications attached thereto indicate that defendant Mildred A. Dunwoody acknowledged her signature before a notary public on 29 April, 1946, that the other defendants acknowledged their signatures before a notary public on 16 April, 1946, and that officers of Montgomery Ward & Co., Incorporated

acknowledged their signatures before a notary public on 28 June, 1946.

XIV.

The buildings destroyed by said fire were the same buildings described in and leased by defendant Mildred A. Dunwoody to the defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh, and Doris G. Baruh under the terms of the lease referred to hereinabove in paragraph V.

The parties hereto reserve the right to offer any further legal evidence to the Court upon the trial of this action as to all facts not hereinbefore expressly agreed upon.

Dated this 31st day of December, 1950.

BERT W. LEVIT,
DAVID C. BOGERT,
LONG & LEVIT,
By /s/ DAVID C. BOGERT,
Attorneys for Plaintiff.

OSCAR SAMUELS and
TEVIS JACOBS,
By /s/ OSCAR SAMUELS,
Attorneys for Defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh.

PETERS AND PETERS,
By /s/ JEROME D. PETERS,
Attorneys for Defendant and Cross-Complainant Mildred A. Dunwoody.

California Standard Form Fire Insurance Policy

No. 4- 24777 SPECIMEN COPY

OTHER INSURANCE PERMITTED EXCEPT AS AGREEMENT ENDORSED HEREON OR ADDED HERETO.

INCORPORATED — 1899

HARDWARE MUTUAL INSURANCE COMPANY OF MINNESOTA

HOME OFFICE: MINNEAPOLIS MINN.

MUTUAL COMPANY
ASSESSABLE
AND LIMITED POLICY

PACIFIC DEPARTMENT: SAN FRANCISCO, CALIFORNIA

Amount $10,000.00	Rate 1.03 - .78	Premium $ 94.00	Total Premium
Extended Coverage	Rate .112	Premium $ 11.20	$ 109.20

The insurance attached in connection with Extended Coverage Perils unless "Rate" and "Premium" is specified above and Extended Coverage endorsement is attached to this policy.

In Consideration of the Stipulations herein named and of ONE THOUSAND NINE AND 20/100 DOLLARS PREMIUM

Does Insure MILDRED A. DUNWOODY

from the TWENTY FOURTH day of SEPTEMBER 19 48, at noon,
to the TWENTY FOURTH day of SEPTEMBER 19 49, at noon
against all loss or damage by fire, except as hereinafter provided. To an amount not exceeding
TEN THOUSAND AND 00/100 Dollars
to the following described property while located and contained as described herein, and not elsewhere,
to-wit:

The company will not be liable beyond the actual cash value of the interest of the insured in the property at the time of loss or damage nor exceeding what it would then cost the insured to repair or replace the same with material of like kind and quality; and such value to be estimated without abatement for any increased cost of repair or construction by reason of any building ordinance regulating repair or construction of buildings, and without compensation for loss resulting from interruption of business or manufacturing.

This policy is made and accepted subject to the foregoing stipulations and conditions and those hereinafter stated, which are hereby specially referred to, and made part of this policy, together with such other provisions, agreements or conditions as may be endorsed hereon or added hereto, and no person, unless duly authorized in writing, shall have power to alter or waive any of the terms or conditions of this policy except as may be provided by the by-laws of the company. This policy shall become void and of no effect if the insured has concealed or misrepresented in writing or otherwise any fact or circumstance concerning this insurance or the subject thereof.

IN WITNESS WHEREOF, the company has executed and attested these presents.

HARWOOD [illegible] Secretary

[illegible] President

Countersigned at San Francisco California
this 31 day of AUGUST 19 48

[illegible] Agent

EXHIBIT "A"

READ THIS POLICY.

Ins. Co. is liable only for actual cash value.

Policy is void in case of any fraud, false swearing, misrepresentation or concealment about material facts.

Policy is void, unless otherwise agreed in writing, if

1st. It is assigned before loss;

2nd. Insured has or shall procure other insurance;

3rd. Any change occurs in location of property;

4th. Insured building is on ground not owned in fee simple by insured;

5th. Insured is not sole and unconditional owner.

Policy is suspended, unless otherwise agreed in writing, if

6th. Described building becomes vacant or unoccupied for 10 days;

7th. Mechanics are employed more than 15 days in repairing same;

8th. Property is or becomes encumbered by chattel mortgage;

9th. Illuminating gas or vapor is generated in or adjacent to described building;

10th. Explosives or prohibited quantities of gasoline, etc., are kept on premises.

Insurance ceases if described building or any material part falls except as result of fire.

Policy does not cover certain enumerated personal property.

Note particularly duty of insured in case of loss;

Also provisions avoiding or suspending policy, including changes of ownership or possession.

(4)

California Standard Form Fire Insurance Policy

Expires: SEPTEMBER 24, 1949

Property: BUILDING

Amount	$ 10,000.00
Fire Premium	$ 98.00
Ext. Cov. Premium	$ 11.20
Total Premium	$ 109.20

Insured MILDRED A DUNWOODY

No. 4- 24777

HARDWARE MUTUAL INSURANCE COMPANY OF MINNESOTA

INCORPORATED 1899
HOME OFFICE
MINNEAPOLIS, MINN.

IMPORTANT
For service communicate with our offices
417 Montgomery Street
San Francisco 4, California

The insured named herein is hereby notified that under the policy it is given in by virtue thereof a member of the Hardware Mutual Insurance Company of Minnesota, and that the annual meeting of said company is held at its Home Office in Minneapolis at 2 o'clock A. M.

It is important that the terms printed on all policies covering the same property read exactly alike. It may do not they should be made uniform at once.

THIS POLICY IS ISSUED BY A MUTUAL COMPANY HAVING SPECIAL REGULATIONS LAWFULLY APPLICABLE TO ITS ORGANIZATION, MEMBERSHIP, POLICIES OR CONTRACTS OF INSURANCE OF WHICH THIS FOLLOWING SHALL APPLY TO AND FORM A PART OF THIS POLICY. THE INSURED SHALL NOT BE SUBJECT TO CONTINGENT OR ASSESSMENT LIABILITY THEREUNDER EXCEPTS FROM THE ARTICLES OF INCORPORATION AND BY-LAWS

THE ANNUAL MEETING OF MEMBERS OF THIS CORPORATION SHALL BE HELD IN THE HOME OFFICE OF THE CORPORATION ON THE THIRD THURSDAY IN JANUARY, PRESENT IN PERSON OR BY PROXY, SHALL BE ENTITLED TO ONE VOTE FOR EACH POLICY HE HOLDS.... NO POLICY ISSUED BY THE CORPORATION SHALL BE SUBJECT TO ASSESSMENT FOR ANY PURPOSE OTHER THAN TO PAY LOSSES AND EXPENSES INCURRED BY THE CORPORATION, AND NO POLICY SHALL BE SUBJECT TO ASSESSMENT FOR LOSSES AND EXPENSES IN EXCESS OF THE MAXIMUM CONTINGENT LIABILITY STATED IN THE POLICY. THE BOARD OF DIRECTORS MAY FROM TIME TO TIME DETERMINE WHETHER THERE IS ANY CONTINGENT LIABILITY UNDER ANY POLICY AND THE AMOUNT THEREOF, AND MAY FROM TIME TO TIME DETERMINE WHEN, AND IN WHAT AMOUNTS, CONTINGENT LIABILITIES SHALL BE ENFORCED. ANY CONTINGENT LIABILITY SO DETERMINED SHALL BE DISTRIBUTED TO THE INSUREDS OF SUCH POLICIES FROM THE SURPLUS OF THE COMPANY AVAILABLE FOR THAT PURPOSE.

Property not covered. This company will not be liable for loss to accounts, bills, evidences of debt or ownership or other documents, or securities, nor, (b) unless liability is specifically assumed hereon, for loss to bullion, casts, curiosities, drawings, models, manuscripts, medals, models, patterns, pictures, scientific apparatus, business or store or office furniture or fixtures, sculptures, frescoes, decorations, or property held on storage or for repair.

Hazards not covered. This company will not be liable for loss by (a) theft; or (b) by neglect of the insured to use all reasonable means to save and preserve the property at and after a fire, or when the property is endangered by fire; or (c) (unless fire ensues, and in that event for the damage by fire only) by explosion of any kind or lightning; or (d) by invasion, insurrection, riot, civil war, or commotion, or riot except as hereinafter provided) by military or usurped power, or order of any civil authority, but the company will be liable (unless otherwise provided by endorsement hereon or added hereto) if the property is lost or damaged, by fire or otherwise, by civil authority or military or usurped power exercised to prevent the spread of fire not originating from a cause excepted hereunder and which fire otherwise probably would have caused the loss of or damage to the insured property.

Matters avoiding policy. This entire policy shall be void, (a) if the insured has concealed or misrepresented any material fact or circumstances concerning this insurance or the subject thereof; or, (b) in case of any fraud or false swearing by the insured touching any matter relating to this insurance or the subject thereof, whether before or after a loss.

Unless otherwise provided by agreement endorsed hereon or added hereto, this entire policy shall be void, (a) if the insured now has or shall procure any other insurance, whether valid or not, on property covered in whole or in part by this policy, or (b) if the interest of the insured be other than unconditional and sole ownership, or (c) if the subject of insurance be a building on ground not owned by the insured in fee simple, or (d) if with the knowledge of the insured foreclosure proceedings be commenced or notice given of sale of any property covered by this policy by virtue of any mortgage or trust deed, or (e) if this policy be assigned before a loss.

Matters suspending insurance. Unless otherwise provided by agreement endorsed hereon or added hereto this company shall not be liable for loss or damage occurring (a) while the hazard be materially increased by any means within the control of the insured; or (b) if the subject of insurance be a manufacturing establishment, while it is operated in whole or in part at night later than ten o'clock or while it ceases to be operated beyond the period of ten consecutive days; or (c) while mechanics or artisans are employed in building or altering or repairing the described premises for more than fifteen days at any one time; or (d) while illuminating gas or vapor be generated in the described building (or adjacent thereto) for use therein; or (e) while there be kept, used or allowed on the described premises (any usage or custom of trade or manufacture to the contrary notwithstanding) calcium carbide phosphorus dynamite nitroglycerine, fireworks or other explosives; or exceeding one quart each of benzine, gasoline, naphtha or other chemicals, or sixty-five pounds of gunpowder; or (f) while a building herein described whether intended for occupation by owner or tenant is vacant or unoccupied beyond the period of ten (10) consecutive days; (g) while the interest in, title to or possession of the subject of insurance is changed excepting:—(1) by the death of the insured; (2) a change of occupancy of building without material increase of hazard; and (3) transfer by one or more several copartners or coowners to the others.

Such suspension shall not extend the term of this policy nor create any right for refund of the whole or any portion of premium, nor affect the respective rights of cancellation.

Chattel mortgage. Unless otherwise provided by agreement endorsed hereon or added hereto this company shall not be liable for loss or damage to any property insured hereunder while encumbered by a chattel mortgage, but the liability of the company upon other property hereby insured shall not be affected by such chattel mortgage.

Fallen building clause. Unless otherwise provided by agreement endorsed hereon or added hereto, if a building or any material part thereof fall, except as the result of fire, all insurance by this policy on such building or its contents shall immediately cease.

Removal when endangered by fire. Should any of said property be necessarily removed because of danger from fire, and there is no other insurance thereon, that part of this policy in excess of the value of the insured property remaining in the original location, or, if there is other insurance thereon, that part of this policy in excess of its proportion of the value of the insured property remaining in the original location, shall, for the ensuing five days only, cover said removed property in its new location or locations.

Cancellation. This policy shall be cancelled at any time at the request of the insured, in which case the company shall, upon surrender of this policy, refund the excess of paid premium above the customary short rates for the expired time. This policy may be cancelled at any time, without tender of unearned portion of premium, by the company by giving five (5) days written notice of cancellation to the insured and to any mortgagee or other party to whom, with the written consent of the company, this policy is made payable, in which case the company shall, upon surrender of the policy or relinquishment of liability thereunder, refund the excess of paid premium above the pro rata premium for the expired time.

Duty of insured in case of loss. When a loss occurs the insured must give to this company written notice thereof without unnecessary delay; and shall protect the property from further damage; forthwith separate the damaged and undamaged personal property and put it in the best possible order; and without unnecessary delay make a complete inventory stating as far as possible the quantity and cost of each article, and the amount claimed thereon.

Within sixty days after the commencement of the fire the insured shall render to the company at its main office in California named hereon preliminary proof of loss consisting of a written statement signed and sworn to by the insured, to the best—(a) his knowledge and belief as to the origin of the fire, (b) the interest of the insured and of all others in the property; (c) the cash value of the different articles or properties and the amount of loss thereon; (d) all incumbrances thereon; (e) all other insurance, whether valid or not, covering any of said articles or properties; (f) a copy of the descriptions and schedules in all other policies unless similar to this policy, and in that event, a statement as to the amounts for which the different articles or properties are insured in each of the other policies, (g) any changes of title, use, occupation, location or possession of said property since the issuance of this policy, (h) by whom and for what purpose any building herein described, and the several parts thereof, were occupied at the time of the fire.

If the company claims that the preliminary proof of loss is defective and within five days after the receipt thereof (without admitting the amount of loss or any part thereof) notifies in writing the insured, or the party making such proof of loss, of the alleged defects (specifically stating them) and requests that they be remedied by verified amendments the insured or such party within ten days after the receipt of such notification and request must comply therewith or, if unable so to do, present to the company an affidavit to that effect.

The insured shall also furnish, if required, as far as it is practicable to obtain the same, verified plans and specifications of any buildings, fixtures or machinery destroyed or damaged, and the insured shall exhibit to any person designated in writing by this company all the remains of any property herein described and shall submit to examination under oath, as often as required, by any such person, and subscribe to the testimony so given and shall produce to such person for examination all books of account, bills, invoices and other vouchers, and permit extracts and copies thereof to be made, and in case the originals are lost certified copies, if obtainable, shall be produced.

Ascertainment of amount of loss. This company shall be deemed to have assented to the amount of the loss claimed by the insured in his preliminary proof of loss, unless within twenty days after the receipt thereof, or, if verified amendments have been requested, within twenty days after their receipt, or within twenty days after the receipt of an affidavit that the insured is unable to furnish such amendments, the company shall notify the insured in writing of its partial or total disagreement with the amount of loss claimed by him and shall also notify him in writing of the amount of loss, if any, the company admits on each of the different articles or properties set forth in the preliminary proof or amendments thereto.

If the insured and this company fail to agree, in whole or in part, as to the amount of loss within ten days after such notification, this company shall forthwith demand in writing an appraisement of the loss or part of loss as to which there is a disagreement and shall name a competent and disinterested appraiser, and the insured within five days after receipt of such demand and name, shall appoint a competent and disinterested appraiser and notify the company thereof in writing, and the two so chosen shall before commencing the appraisement, select a competent and disinterested umpire.

The appraisers together shall estimate and appraise the loss or part of loss as to which there is a disagreement, stating separately the sound value and damage, and if they fail to agree they shall submit their differences to the umpire, and the award in writing duly verified of any two shall determine the amount or amounts of such loss.

The parties to the appraisement shall pay the appraisers respectively appointed by them and shall bear equally the expense of the appraisement and the charges of the umpire.

If for any reason not attributable to the insured, or to the appraiser appointed by him, an appraisement is not had and completed within ninety days after said preliminary proof of loss is received by this company, the insured is not to be prejudiced by the failure to make an appraisement, and may prove the amount of his loss in an action brought without such appraisement.

Options of company in case of loss. This company may, at its option, take all or any part of the property for which insurance hereunder is claimed at its ascertained or appraised value, and may also, at its option, in satisfaction of its liability hereunder, repair, rebuild or replace any building or structure or machine or machinery used therein, with other of like kind and quality, within a reasonable time, upon giving notice within twenty days of its intention so to do after the receipt by it of the preliminary proof of loss, or, if verified amendments have been requested, within twenty days after their receipt, or within twenty days after the receipt of an affidavit that the insured is unable to furnish such amendments.

There can be no abandonment to this company of any property.

Apportionment of loss. This company shall not be liable under this policy for a greater proportion of any loss on the described property, or for loss by, and expenses of, removal from the premises endangered by fire, than the amount hereby insured bears to the entire insurance covering such property whether valid or not, or by solvent or insolvent insurers.

Loss when payable. A loss hereunder shall be payable in thirty days after the amount thereof has been ascertained either by agreement or by appraisement; but if such ascertainment is not had or made within sixty days after the receipt by the company of the preliminary proof of loss, then the loss shall be payable in ninety days after such receipt.

Non-waiver by appraisal or examination. This company shall not be held to have waived any provision or condition of this policy or any forfeiture thereof, by assenting to the amount of the loss or damage or by any requirement, act, or proceeding on its part relating to the appraisal or to any examination herein provided for.

Subrogation. If this company shall claim that the fire was caused by the act or neglect of any person or corporation, this company shall, on payment of the loss be subrogated to the extent of such payment to all right of recovery by the insured for the loss resulting therefrom, and such right shall be assigned to this company by the insured on receiving such payment.

Time for commencement of action. No suit or action on this policy for the recovery of any claim shall be sustained, until after full compliance by the insured with all of the foregoing requirements, nor unless begun within fifteen months next after the commencement of the fire.

Definitions. Wherever in this policy the word "insured" occurs, it shall be held to include the legal representatives of the insured in case of his death, and wherever the word "loss" occurs, it shall be deemed the equivalent of "loss or damage," and wherever the words "the time of loss or damage" are used they shall be deemed the equivalent of "the time of the commencement of the fire."

This policy, subject to all its stipulations and conditions, is hereby extended to cover loss by fire only in the same manner and to the same extent as though the words "riot" and "or commotion" were not in line 39 of the printed conditions of the policy.

ASSIGNMENT OF INTEREST BY INSURED

The interest of _____ as owner of the property
covered by this Policy is hereby assigned to _____
subject to the consent of _____
(Name of Company)

Dated _____

_____
(Signature of Insured)

CONSENT BY COMPANY TO ASSIGNMENT OF INTEREST

_____ (Name of Company) , hereby consents that the interest of _____ as owner of the property
covered by this Policy be assigned to _____
Dated _____

_____ Agent

Building, Equipment and Stock Form

Attached to and forming part of Policy No. 4-24777 of the Hardware Mutual Insurance Co. of Minnesota.

Issued to Mildred A. Dunwoody.

Agency at San Francisco, California.

Dated September 24, 1948.

This policy covers the following described property, all situated 223-225 Main Street (Page 19, Line 19).

Town of Chico, State of California.

*Item 1. $8,000.00 on the one story composition roof brick building while occupied as florist and auto parts store.

*Item 2. 1.03F—.112EC on equipment, pertaining to Insured's occupancy as all only while contained in, on or attached to the above described building.

*Item 3. $..... on stock, consisting principally of all only while contained in, on or attached to the above described building.

*Item 4. $2,000.00 on the one story brick building with composition roof while situated at 227-229 Main Street, Chico, California (Page 19, Line 24).

*Item 5. .78F—.112EC on

*6. Insurance Attaches Hereunder Only to Those Items for Which an Amount Is Shown in the Space Provided Therefor and Not Exceeding Said Amount Under Such Item(s). For Definition of Terms "Building," "Equipment," "Stock," See Paragraph 7 Below; for Extensions and Exclusions See Paragraphs Nos. 8 and 10 Below.

7. Definition of Terms:

(I) Building: Building or structure in its entirety, including all fixtures and machinery used for the service of the building itself, provided such fixtures and machinery are contained in or attached to and constitute a part of the building; additions in contact therewith; frescoes and all other decorations, permanently affixed to and constituting a part thereof; platforms, chutes, conveyors, bridges, trestles, canopies, gangways, and similar exterior structures attached thereto and located on the above described premises, provided, that if the same connect with any other building or structure owned by the named Insured, then this insurance shall cover only such portion of the same situate on the above-described premises as lies between the building covered under this policy and a point midway between it and such other building or structure; also (a) awnings, signs, door and window shades and screens, storm doors and storm windows; (b) cleaning and fire fighting apparatus; (c) janitors' supplies, tools and implements; (d) materials and supplies intended for use in construction, alterations or repairs of the building. Provided, however, that property described in (a), (b), (c) and (d) immediately above must be, at the time of any loss, (1) the property of the named Insured who is the owner of the building; and (2) used for the maintenance or service of the building; and (3) contained in or attached to the building; and (4) not specifically covered under an item other than the "Building" item of this or any other policy.

(II) Equipment: Equipment and personal property of every description, including property on which liability is required to be specifically assumed by the standard policy conditions, and, provided the described building is not owned by the named Insured, "Tenant's Improvements and Betterments" installed or paid for by the named Insured: but Excluding, (1) Bullion, Manuscripts, and Machine Shop or Foundry Patterns, (2) Property (Whether Covered Under This Policy or Not) Included Within the Description or Definition of "Stock," (3) Property Kept for Sale, and (4) Property Covered Under the "Building" Item of This or Any Other Policy.

(III) Stock: Stock of goods, wares and merchandise of every description, manufactured, unmanufactured, or in process of manufacture; materials and supplies which enter into the manufacture, packing, handling, shipping and sale of same; advertising material; all being the property of the named Insured, or sold but not removed (it being understood that the actual cash value of stock sold but not removed shall be the Insured's selling price); and the Insured's interest in materials, labor and charges furnished, performed on or incurred in connection with the property of others.

8. Extension Clause: Personal property of the kind and nature covered under any item hereof shall be covered under the respective item (a) while in, on, or under sidewalks, streets, platforms, alleyways or open spaces, provided such property is located

within 50 feet of the described "Building," and (b) while in or on cars and vehicles within 300 feet of the described "Building," and (c) while in or on barges and scows or other vessels within 100 feet of the described premises; provided such property is not covered by marine, inland marine or transportation insurance of any kind.

9. Trust and Commission Clause: To the extent that the named Insured shall be liable by law for loss thereto or shall prior to loss have specifically assumed liability therefor, any item of this policy covering on personal property shall also cover property of the kind and nature described in such item, at the location(s) herein indicated, held in trust, or on consignment or commission, or on joint account with others, or left for storage or repairs.

10. Exclusion Clause: In Addition to Property Expressly Excluded From Coverage by Any Provision of This Form or Other Endorsement Attached To This Policy, the Following Are Not Covered Under Any Item of This Policy and Are To Be Excluded In the Application of Any "Average Clause" or "Distribution Clause": Land Values, Gardens, Trees, Lawns, Plants, Shrubbery, Accounts, Bills, Currency, Evidences of Debt or Ownership or Other Documents, Money, and Notes or Securities, Aircraft, Boats, Motor Vehicles.

11. Loss, if any, under each item of this policy shall be adjusted with and payable to the Insured specifically named herein unless otherwise agreed in writing by this Company.

12. Loss, if any under item(s) ..... subject to all the terms and conditions of this policy, and to the written agreement, if any, between this Insurer and the following named Payee, is payable to..... .....whose mailing address is.....

13. Average Clause (This Clause Void Unless Percentage Is Inserted): In Event of Loss to Property Described In Any Item of This Policy as to Which Item a Percentage Figure Is Inserted In This Clause, This Company Shall Be Liable for No Greater Proportion of Such Loss Than the Amount of Insurance Specified In Such Item Bears To the Following Percentage of the Actual Value of the Property Described In Such Item at the Time of Loss, nor for More Than the Proportion Which the Amount of Insurance Specified In Such Item Bears to the Total Insurance on the Property Described In Such Item at the Time of Loss: Seventy Per Cent (70%) Applying to Item No. 1 and 4; ..... Per Cent (..%) Applying to Item No. ....; .... Per Cent (..%) Applying to Item No. ——.

If this policy be divided into two or more items, the foregoing conditions shall apply to each item separately.

14. Waiver of Inventory and Appraisement Clause: If any item of this policy is subject to the conditions of the Average Clause (Paragraph 13 above), it is also provided that when an aggregate claim for any loss to the property described in any such item of this policy is both less than Five Thousand Dollars ($5,000.00) and less than two per cent

(2%) of the total amount of insurance upon the property described in such item at the time such loss occurs, it shall not be necessary for the Insured to make a special inventory or appraisement of the undamaged property. But Nothing Herein Contained Shall Operate to Waive the Application of the Average Clause to Any Such Loss.

If this policy be divided into two or more items, the foregoing conditions shall apply to each item separately.

15. Excess Insurance Limitation Clause: No Item of This Policy Shall Attach to or Become Insurance Upon Any Property, Included Within the Description of Such Item, Which at the Time of Any Loss.

(a) Is More Specifically Described and Covered Under Another Item of This Policy, or Under Any Other Policy Carried By or In the Name of the Insured Named Herein, or

(b) Being the Property of Others Is Covered By Insurance Carried By or In the Name of Others Than the Insured Named Herein.

Until the Liability of Insurance Described Under (a) or (b) Has First Been Exhausted, and shall Then Cover Only the Excess of Value of Such Property Over and Above the Amount Payable Under Such Other Insurance, Whether Collectible or Not. This Clause Shall Not Be Applicable to Property of Others for the Loss of Which the Insured Named Herein Is Liable By Law or Has Prior To Any Loss Specifically Assumed Liability.

The Provisions Printed on the Back of This Form are Hereby Referred To and Made a Part Hereof.

V. J. MALONE,
Agent.

Provisions Referred To In and Made Part of This Form (No. 78-C)

16. Tenant's Improvements and Betterments Clause: "Tenant's Improvements and Betterments" (subject to the provisions of the paragraph hereof entitled "Equipment") are covered as property of the named Insured under the "Equipment" item of this policy, regardless of whether or not the same have or will become a permanent or integral part of the building(s) or the property of the building owner or lessor. The amount of loss on such "Tenant's Improvements and Betterments" shall be determined on the basis of the actual cash value thereof at the time of loss, irrespective of any limitation upon the interest of the Insured therein resulting from any lease or rental agreement affecting the same. The insurance on such "Tenant's Improvements and Betterments" shall not be prejudiced, nor shall the amount recoverable for loss thereon be diminished, because of insurance covering on the same issued in the name of the owner of said building(s) or of others than the Insured named in this policy. This Policy, However, Shall not Contribute to the Payment of Any Loss to "Tenant's Improvements and Betterments" Covered Under Any Policy or Policies Issued In the Name of the

Owner of Said Building(s) or of Others Than the Insured Named In This Policy.

17. Consequential Damage Assumption Clause: (To apply only if stock of merchandise, provisions or supplies in cold storage, which stock is subject to damage through change of temperature, are covered hereunder.) This Company (Subject to the Terms of This Policy) Shall Be Liable for Consequential Loss or Damage to Stock of Merchandise, Provisions and Supplies In Cold Storage Covered Hereunder Caused by Change of Temperature Resulting From Total or Partial Destruction by Any Peril Insured Against In This Policy, of Refrigerating or Cooling Apparatus, Connections or Supply Pipes Thereof, Unless Such Loss Is Specifically Excluded as to Any Such Peril by Express Provision of Any Form, Rider or Endorsement Attached to This Policy.

The Total Liability for Loss or Damage Caused by Any Peril Insured Against in This Policy and by Such Consequential Loss or Damage, Either Separately or Together, Shall In No Case Exceed the Total Amount of This Policy In Effect at the Time of Loss, If There Is Other Insurance Upon the Property Damaged Covering the Perils, or Any Thereof, Which Are Insured Against in This Policy, This Company Shall Be Liable Only for Such Proportion of Any Consequential Loss or Damage as the Amount Hereby Insured Bears To the Whole Amount of Insurance Thereon Whether Such Other Insurance Covers Against Consequential Loss or Damage or Not.

If the Building or Any Material Part Thereof Fall, Except as a Result of Fire, All Insurance by This Policy Shall Immediately Cease Provided That There Be No Fallen Building Clause Waiver Made a Part of This Policy.

18. Breach of Warranty Clause: If a breach of any warranty or condition contained in any rider attached to or made a part of this policy shall occur, which breach by the terms of such warranty or condition shall operate to suspend or avoid this insurance, it is agreed that such suspension or avoidance due to such breach, shall be effective only during the continuance of such breach and then only as to the building, fire division, contents therein, or other separate location to which such warranty or condition has reference and in respect of which such breach occurs.

19. Subrogation Waiver Clause: This insurance shall not be prejudiced by agreement made by the named Insured releasing or waiving this Company's right of subrogation against third parties responsible for the loss, under the following circumstances only:

(I) If made before loss has occurred, such agreement may run in favor of any third party;

(II) If Made After Loss Has Occurred, Such Agreement May Run Only in Favor of a Third Party Falling Within One of the Following Categories at the Time of Loss:

(a) Third Party Insured Under This Policy; or

(b) A Corporation, Firm, or Entity (1) Owned or Controlled by the Named Insured or in Which the Named insured Owns Capital Stock or Other Proprietary Interest, or (2) Owning or Controlling the Named Insured or Owning or Controlling Capital Stock or Other Proprietary Interest in the Named Insured:

(III) Whether Made Before or After Loss Has Occurred, Such Agreement Must Include a Release or Waiver of the Entire Right of Recovery of the Named Insured Against Such Third Party.

20. Automatic Reinstatement Clauses: (a) Applying to Losses not Exceeding One Hundred Dollars ($100.00) Under This Policy: The amount of insurance hereunder involved in a loss payment of not More Than One Hundred Dollars ($100.00) for This Policy shall be automatically reinstated.

(b) Applying to Losses in Excess of One Hundred Dollars ($100.00) Under This Policy: In the event of any loss payment under this policy in excess of One Hundred Dollars ($100.00) the amount paid shall be deemed reinstated and this policy automatically reinstated to the full amount in force immediately preceding said loss, Provided That the Policy Shall be Endorsed to That Effect Within 30 Days After the Payment of Loss, and the Insured Shall Pay to the Company the Pro Rata Premium for the Unexpired Time From the Date of Said Loss to the Expiration of This Policy, at the Rate in Force at the Time of Said Reinstatement. This clause shall apply to each loss separately.

21. Loss by Fire Resulting From "Riot" and "or Commotion" Clause: This policy, subject to all its stipulations and conditions, is hereby extended to cover loss by fire only in the same manner and to the same extent as though the words "riot" and "or commotion" were not in line 39 of the printed conditions of the policy.

22. Vacancy—Unoccupancy—Cessation of Operations Clause: Unless otherwise specified by endorsement added hereto: (a) If the subject of this insurance be a manufacturing, mill, or mining plant, permission is granted to remain vacant or unoccupied or to shut down and cease operations, for a period of not to exceed sixty (60) consecutive days at any one time; or (b) If the subject of insurance be a cannery, fruit, nut or vegetable packing or processing plant, fish reduction plant, hop kiln, rice drier, beet sugar factory, cotton gin, cotton compress or cotton seed oil mill, permission is granted to remain vacant or unoccupied for a period of not to exceed sixty (60) consecutive days at any one time, or to shut down and cease operations (but not to be vacant) for a period of not to exceed ten (10) months at any one time; (c) Except as otherwise provided in (a) and (b) immediately above, permission is granted to remain vacant or unoccupied without limit of time. Nothing herein contained shall be construed to abrogate or modify any provision or warranty of this policy requiring (1) the maintenance of watchman service; (2) the maintenance of all fire extinguishing appliances and apparatus including sprinkler system, and water

supply therefor, and fire detecting systems, in complete working order; nor to extend the term of this policy.

23. Permits and Agreements Clause: Permission granted: (a) For other insurance; (b) For such use of the premises as is usual or incidental to the business conducted therein and for existing and increased hazards and for change in use or occupancy except as to any specific hazard, use, or occupancy prohibited by the express terms of this policy or by any endorsement thereto; (c) To generate and use illuminating gas or vapor; (d) To keep and use all articles and materials usual and incidental to said business, in such quantities as the exigencies of the business require; (e) To work and operate at any and all times but without extending the term of this policy; (f) For the building(s) to be in course of construction, alteration or repair, all without limit of time but without extending the term of this policy, and to build additions thereto, and this policy under its respective item(s) shall cover on or in such additions in contact with such building(s); but if any building herein described is protected by automatic sprinklers, this permit shall not be held to include the reconstruction or the enlargement of any building so protected, without the consent of this Company in writing. This permit does not waive or modify any of the terms or conditions of the Automatic Sprinkler Clause (if any) attached to this policy.

This insurance shall not be prejudiced: (1) If the property covered hereunder is on ground not owned

by the Insured in fee simple; (2) If the interest of the Insured in said property, or any part thereof, is other than that of unconditional and sole ownership; (3) If any part of said property be or become encumbered by any mortgage, or other encumbrance, or by the making of a contract of sale thereof; (4) If foreclosure proceedings be commenced or notice of sale be given in regard to any property insured hereunder; (5) By any act or neglect of the owner of the building if the Insured is not the owner thereof, or by any act or neglect of any occupant of the building (other than the named Insured), when such act or neglect of the owner or occupant is not within the control of the named Insured; (6) By failure of the named Insured to comply with any warranty or condition contained in any form, rider or endorsement attached to this policy with regard to any portion of the premises over which the named Insured has no control; nor (7) shall any insurance hereunder on building(s) be prejudiced by any error in stating the name, number, street or location of such building(s).

24. Lightning Clause: Except as Herein Provided, This Policy Also Covers Direct Loss or Damage Caused by Lightning (Meaning Thereby the Commonly Accepted Use of the Term "Lightning") Whether Fire Ensues or not, Subject in All Other Respects to the Terms and Conditions of This Policy; Provided, However, That if There Shall be Any Other Insurance on the Described Property This Company Shall Be Liable Only Pro Rata With

Such Other Insurance for Any Direct Loss by Lightning Whether Such Other Insurance Be Against Direct loss by Lightning or Not.

This Lightning Clause Does Not Increase the the Amount or Amounts of Insurance Provided in This Policy.

25. Electrical Apparatus Clause: If Electrical Appliances or Devices (Including Wiring) are Covered Under This Policy, This Company Shall not be Liable for Any Electrical Injury or Disturbance to the Said Electrical Appliances or Devices (Including Wiring) Caused by Electrical Currents Artifically Generated Unless Fire Ensues, and if Fire Does Ensue This Company Shall be liable Only for Its Proportion of Loss or Damage Caused by Such Ensuing Fire.

FORM 201 (JULY 1944) CALIFORNIA

EXTENDED COVERAGE ENDORSEMENT

(PERILS OF WINDSTORM, HAIL, EXPLOSION, RIOT, RIOT ATTENDING A STRIKE, CIVIL COMMOTION, AIRCRAFT, VEHICLES, SMOKE, EXCEPT AS HEREINAFTER PROVIDED, AND WAIVER OF FALLEN BUILDING CLAUSE)

Rate for extended coverage .11?

In consideration of $ 11.20 premium, and subject to provisions and stipulations hereinafter referred to as "provisions" herein and in the policy to which this endorsement is attached, including riders and endorsements thereon, the coverage of this policy is extended to include direct loss by WINDSTORM, HAIL, EXPLOSION, RIOT, RIOT ATTENDING A STRIKE, CIVIL COMMOTION, AIRCRAFT, VEHICLES, AND SMOKE.

THIS ENDORSEMENT DOES NOT INCREASE THE AMOUNT OR AMOUNTS OF INSURANCE PROVIDED IN THE POLICY TO WHICH IT IS ATTACHED.

If this policy covers on two or more items, the provisions of this endorsement shall apply to each item separately.

SUBSTITUTION OF TERMS: In the application of the provisions of this policy, including riders and endorsements (but not this endorsement), to the perils covered by this Extended Coverage Endorsement, wherever the word "fire" appears there shall be substituted therefor the peril involved or the loss caused thereby, as the case requires.

APPORTIONMENT CLAUSE: THIS COMPANY SHALL NOT BE LIABLE FOR A GREATER PROPORTION OF ANY LOSS FROM ANY PERIL OR PERILS INCLUDED IN THIS ENDORSEMENT THAN (1) THE AMOUNT OF INSURANCE UNDER THIS POLICY BEARS TO THE WHOLE AMOUNT OF FIRE INSURANCE COVERING THE PROPERTY, WHETHER VALID OR NOT AND WHETHER COLLECTIBLE OR NOT, AND WHETHER OR NOT SUCH OTHER FIRE INSURANCE COVERS AGAINST THE ADDITIONAL PERIL OR PERILS INSURED HEREUNDER, (2) NOR FOR A GREATER PROPORTION THAN THE AMOUNT OF INSURANCE UNDER THIS POLICY BEARS TO THE AMOUNT OF ALL INSURANCE, WHETHER VALID OR NOT AND WHETHER COLLECTIBLE OR NOT, COVERING IN ANY MANNER SUCH LOSS; FURTHERMORE, IF THERE BE INSURANCE OTHER THAN FIRE INSURANCE COVERING ANY ONE OR MORE OF THE PERILS CAUSING LOSS HEREUNDER, COVERING SPECIFICALLY ANY INDIVIDUAL UNIT OF PROPERTY INVOLVED IN THE LOSS, ONLY SUCH PROPORTION OF THE INSURANCE UNDER THIS POLICY SHALL APPLY TO SUCH UNIT SPECIFICALLY INSURED AS THE VALUE OF SUCH UNIT SHALL BEAR TO THE TOTAL VALUE OF ALL THE PROPERTY COVERED UNDER THIS POLICY, WHETHER SUCH OTHER INSURANCE CONTAINS A SIMILAR CLAUSE OR NOT.

GLASS CLAUSE: IT IS EXPRESSLY STIPULATED AS APPLICABLE TO ALL PERILS INCLUDED IN THIS ENDORSEMENT THAT ONLY SUCH PROPORTION OF THE INSURANCE UNDER THIS POLICY ON ANY BUILDING COVERS ON PLATE, STAINED, LEADED OR CATHEDRAL GLASS THEREIN AS THE VALUE OF SUCH GLASS WHICH IS DAMAGED BEARS TO THE TOTAL VALUE OF SAID BUILDING.

WAR RISK EXCLUSION CLAUSE: THIS COMPANY SHALL NOT BE LIABLE FOR LOSS BY ANY OF THE PERILS INSURED AGAINST IN THIS ENDORSEMENT CAUSED, DIRECTLY OR INDIRECTLY, BY: (A) ENEMY ATTACK BY ARMED FORCES, INCLUDING ACTION TAKEN BY MILITARY, NAVAL OR AIR FORCES IN RESISTING AN ACTUAL OR AN IMMEDIATELY IMPENDING ENEMY ATTACK; (B) INVASION; (C) INSURRECTION; (D) REBELLION; (E) REVOLUTION; (F) CIVIL WAR; (G) USURPED POWER.

WAIVER OF POLICY PROVISIONS: A claim for loss from perils included in this endorsement shall not be barred because building is not on ground owned by the Insured in fee simple, factory operations have ceased, of change of occupancy, of existence of encumbrance, of factory operations at night, nor because of vacancy or unoccupancy.

Attached to and forming part of Policy No. 4-24777

of the HARDWARE MUTUAL INSURANCE CO OF MINN.
Name of Insurance Company

issued at its SAN FRANCISCO, CALIFORNIA Agency. Dated SEPTEMBER 24, 1943

TRADE MARK STANDARD REG. U.S. PAT. OFF.
201
JULY 1944

V. J. Malone Agent

THE PROVISIONS PRINTED ON THE BACK OF THIS FORM ARE HEREBY REFERRED TO AND MADE A PART HEREOF.

83

PROVISIONS REFERRED TO IN AND MADE PART OF THIS FORM (No. 201)

PROVISIONS APPLICABLE ONLY TO WINDSTORM AND HAIL: THIS COMPANY SHALL NOT BE LIABLE FOR LOSS CAUSED DIRECTLY OR INDIRECTLY BY (A) FROST OR COLD WEATHER OR (B) SNOWSTORM, TIDAL WAVE, HIGH WATER OR OVERFLOW, WHETHER DRIVEN BY WIND OR NOT.

THIS COMPANY SHALL NOT BE LIABLE FOR LOSS TO THE INTERIOR OF THE BUILDING OR THE INSURED PROPERTY THEREIN CAUSED, (A) BY RAIN, SNOW, SAND OR DUST, WHETHER DRIVEN BY WIND OR NOT, UNLESS THE BUILDING INSURED OR CONTAINING THE PROPERTY INSURED SHALL FIRST SUSTAIN AN ACTUAL LOSS TO ROOF OR WALLS BY THE DIRECT FORCE OF WIND OR HAIL AND THEN SHALL BE LIABLE FOR LOSS TO THE INTERIOR OF THE BUILDING OR THE INSURED PROPERTY THEREIN AS MAY BE CAUSED BY RAIN, SNOW, SAND OR DUST ENTERING THE BUILDING THROUGH OPENINGS IN THE ROOF OR WALLS MADE BY DIRECT ACTION OF WIND OR HAIL OR (B) BY WATER FROM SPRINKLER EQUIPMENT OR OTHER PIPING, UNLESS SUCH EQUIPMENT OR PIPING BE DAMAGED AS A DIRECT RESULT OF WIND OR HAIL.

UNLESS LIABILITY THEREFOR IS ASSUMED IN THE FORM ATTACHED TO THIS POLICY, OR BY ENDORSEMENT HEREON, THIS COMPANY SHALL NOT BE LIABLE FOR DAMAGE TO THE FOLLOWING PROPERTY: (A) GRAIN, HAY, STRAW OR OTHER CROPS OUTSIDE OF BUILDINGS OR (B) WINDMILLS, WINDPUMPS OR THEIR TOWERS, CLOTH AWNINGS, SIGNS, METAL SMOKESTACKS, TEMPORARY OR BOARD ROOF ADDITIONS, OR (C) BUILDINGS (OR THEIR CONTENTS) IN PROCESS OF CONSTRUCTION OR RECONSTRUCTION UNLESS ENTIRELY ENCLOSED AND UNDER ROOF WITH ALL OUTSIDE DOORS AND WINDOWS PERMANENTLY IN PLACE.

PROVISIONS APPLICABLE ONLY TO EXPLOSION: THIS COMPANY SHALL NOT BE LIABLE FOR LOSS BY EXPLOSION ORIGINATING WITHIN STEAM BOILERS, STEAM PIPES, STEAM TURBINES, STEAM ENGINES, FLY-WHEELS, LOCATED IN THE BUILDING(S) INSURED OR IN BUILDING(S) CONTAINING THE PROPERTY INSURED.

ANY OTHER EXPLOSION CLAUSE MADE A PART OF THIS POLICY IS SUPERSEDED BY THIS ENDORSEMENT.

PROVISIONS APPLICABLE ONLY TO RIOT, RIOT ATTENDING A STRIKE AND CIVIL COMMOTION: Loss by riot, riot attending a strike or civil commotion shall include direct loss by acts of striking employees of the owner or tenant(s) of the described building(s) while occupied by said striking employees and shall also include direct loss from pillage and looting occurring during and at the immediate place of a riot, riot attending a strike or civil commotion. THIS COMPANY SHALL NOT BE LIABLE, HOWEVER, FOR LOSS RESULTING FROM DAMAGE TO OR DESTRUCTION OF THE DESCRIBED PROPERTY OWING TO CHANGE IN TEMPERATURE OR INTERRUPTION OF OPERATIONS RESULTING FROM RIOT OR STRIKE OR OCCUPANCY BY STRIKING EMPLOYEES OR CIVIL COMMOTION, WHETHER OR NOT SUCH LOSS, DUE TO CHANGE IN TEMPERATURE OR INTERRUPTION OF OPERATIONS, IS COVERED BY THIS POLICY AS TO OTHER PERILS.

PROVISIONS APPLICABLE ONLY TO LOSS BY AIRCRAFT AND VEHICLES: Loss by "aircraft" includes direct loss by objects falling therefrom. The term "vehicles," as used in this endorsement, means vehicles running on land or tracks. THIS COMPANY SHALL NOT BE LIABLE, HOWEVER, FOR LOSS (A) BY ANY VEHICLE OWNED OR OPERATED BY THE INSURED OR BY ANY TENANT OF THE DESCRIBED PREMISES; (B) TO AIRCRAFT OR VEHICLES INCLUDING CONTENTS OTHER THAN STOCKS OF AIRCRAFT OR VEHICLES IN PROCESS OF MANUFACTURE OR FOR SALE; (C) TO FENCES, DRIVEWAYS, SIDEWALKS OR LAWNS.

PROVISIONS APPLICABLE TO SMOKE: THE TERM "SMOKE" AS USED IN THIS ENDORSEMENT MEANS ONLY SMOKE DUE TO A SUDDEN, UNUSUAL AND FAULTY OPERATION OF ANY HEATING OR COOKING UNIT, ONLY WHEN SUCH UNIT IS CONNECTED TO A CHIMNEY BY A SMOKE PIPE, AND WHILE IN OR ON THE PREMISES DESCRIBED IN THIS POLICY, EXCLUDING, HOWEVER, SMOKE FROM FIREPLACES OR INDUSTRIAL APPARATUS.

PROVISIONS APPLICABLE ONLY WHEN THIS ENDORSEMENT IS ATTACHED TO A POLICY COVERING BUSINESS INTERRUPTION (USE AND OCCUPANCY), EXTRA EXPENSE, RENTS, LEASEHOLD INTEREST OR PROFITS AND COMMISSIONS: WHEN THIS ENDORSEMENT IS ATTACHED TO A POLICY COVERING BUSINESS INTERRUPTION (USE AND OCCUPANCY), EXTRA EXPENSE, RENTS, LEASEHOLD INTEREST, PROFITS AND COMMISSIONS, THE TERM "DIRECT," AS APPLIED TO LOSS, MEANS LOSS, AS LIMITED AND CONDITIONED IN SUCH POLICY, RESULTING FROM DIRECT LOSS TO DESCRIBED PROPERTY FROM PERILS INSURED AGAINST; AND, WHILE THE BUSINESS OF THE OWNER OR TENANT(S) OF THE DESCRIBED BUILDING(S) IS INTERRUPTED BY A STRIKE AT THE DESCRIBED LOCATION, THIS COMPANY SHALL NOT BE LIABLE FOR ANY LOSS OWING TO INTERFERENCE BY ANY PERSON(S) WITH REBUILDING, REPAIRING OR REPLACING THE PROPERTY DAMAGED OR DESTROYED OR WITH THE RESUMPTION OR CONTINUATION OF BUSINESS.

FALLEN BUILDING CLAUSE WAIVER: The provisions, if any, in this policy to the effect that if the building or any part thereof fall, except as the result of fire, all insurance by this policy shall immediately cease, are hereby waived.

NOTE: NOTHING CONTAINED IN THE FOREGOING CLAUSE ENTITLED "FALLEN BUILDING CLAUSE WAIVER" SHALL RENDER THIS COMPANY LIABLE IN ANY WAY FOR LOSS OR DAMAGE CAUSED BY EARTHQUAKE, UNLESS FIRE OR ANY PERIL SPECIFICALLY INSURED AGAINST BY THIS ENDORSEMENT, SHALL ENSUE, AND IN THAT EVENT FOR THE DAMAGE ONLY BY FIRE OR BY SUCH PERIL SPECIFICALLY INSURED AGAINST BY THIS ENDORSEMENT, BUT SUBJECT TO ALL THE TERMS, CONDITIONS AND PROVISIONS OF THIS POLICY INCLUDING THIS ENDORSEMENT.

EXHIBIT B

[Exhibit B is identical to Exhibit A attached to Amended Answer of Defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh and is set out in full at pages 18 to 25 of this printed record.]

EXHIBIT C

[Exhibit C is identical to Exhibit B attached to Amended Answer of Defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh and is set out in full at pages 25 to 29 of this printed record.]

[Endorsed]: Filed January 5, 1951.

[Title of District Court and Cause.]

SUPPLEMENT TO "STIPULATION TO ADMIT CERTAIN FACTS"

It Is Stipulated that there may be added to Paragraph VII of "Stipulation to Admit Certain Facts" on file herein, the following:

"That said Security Insurance Company admitted liability in full under said policy of insurance and paid thereunder to Harold F. Baruh and Harold A. Goldman the sum of Twenty Five Thousand Dollars ($25,000.00), and restained, as provided by the policy, the sum of Eleven Thousand Seven Hundred Forty Three and 89/100 Dollars ($11,743.89), to be paid to said parties at a later date; that of

the Twenty Five Thousand Dollars ($25,000.00), paid to the defendants, Harold F. Baruh and Harold A. Goldman as aforementioned, they expended the sum of One Thousand One Hundred Seventy Three and 89/100 Dollars ($1,173.89), to remove the debris upon the property caused by the burned buildings, and the balance, at the request of the defendant and cross-complainant, Mildred A. Dunwoody, was placed by said parties in a savings account in a bank in San Francisco, to be withdrawn only upon the signatures of Mildred A. Dunwoody and Harold F. Baruh or Harold A. Goldman.

Dated this 31st day of December, 1950.

BERT W. LEVIT,
DAVID C. BOGERT,
LONG & LEVIT,
By /s/ DAVID C. BOGERT,
Attorneys for Plaintiff,

OSCAR SAMUELS and
TEVIS JACOBS,
By /s/ OSCAR SAMUELS,
Attorneys for Defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh.

PETERS and PETERS,
By /s/ JAMES D. PETERS,
Attorneys for Defendant and Cross-Complainant Mildred A. Dunwoody.

[Endorsed]: Filed January 5, 1951.

[Title of District Court and Cause.]

INTERROGATORIES PROPOUNDED BY PLAINTIFF

Now Comes Hardware Mutual Insurance Co., of Minnesota, a corporation, Plaintiff and Cross-Defendant herein, and requires Mildred A. Dunwoody, Defendant and Cross-Complainant herein, to answer separately and fully in writing under oath the following interrogatories filed pursuant to Rule 33 of the Federal Rules of Civil Procedure:

Interrogatory No. 1. At whose request did you sign that certain agreement, dated as of 16 April, 1946, between you as Landlord and H. A. Goldman, Myrtle Goldman, H. F. Baruh, and Doris G. Baruh, as Tentant, a copy of which is incorporated as Exhibit "B" in the Stipulation to Admit Certain Facts on file in this action?

Interrogatory No. 2. Did the persons named as Tenant in said agreement, or anyone on their behalf, state the purpose for which said agreement was prepared?

Interrogatory No. 3. If your answer to the preceding interrogatory is in the affirmative, please state the names of the persons and the purpose of the agreement as explained to you by them.

Interrogatory No. 4. Did you delay signing the agreement referred to above as Exhibit "B" until Harold Goldman and Harold Baruh had signed, or agreed to sign, that certain agreement between you

and them dated 23 April, 1946, a copy of which is incorporated as Exhibit "C" in the Stipulation to Admit Certain Facts on file in this action?

Interrogatory No. 5. Describe the negotiations preceding the execution by you of the agreements identified hereinabove as Exhibits "B" and "C."

Interrogatory No. 6. Was it your intention and purpose, at all times mentioned above, that the other defendants in this action remain bound by that provision in paragraph 12 of your lease agreement with them requiring that the buildings leased to them under said lease be restored by them at their own expense without unnecessary delay if they were partially or totally destroyed by fire?

Interrogatory No. 7. If your answer to the preceding interrogatory is in the affirmative, did you notify Harold A. Goldman or Harold F. Baruh before or at the time of signing the agreement identified hereinabove as Exhibit "B" that such was your intention and purpose?

Interrogatory No. 8. Did you, prior to 8 April, 1949, make any agreements with the other defendants, or any of them, relative to their obligation to rebuild the buildings leased by you to them, other than the agreements referred to above as Exhibits "B" and "C"?

Interrogatory No. 9. If your answer to the preceding interrogatory is in the affirmative, state the substance of said agreements, the dates they were made, and whether they were oral or in writing.

Interrogatory No. 10. Did you, subsequent to 8 April, 1949, make any agreements with the other defendants, or any of them, relative to their obligation to rebuild the buildings leased by you to them, other than the agreements referred to above as Exhibits "B" and "C"?

Interrogatory No. 11. If your answer to the preceding interrogatory is in the affirmative, state the substance of said agreements, the dates they were made, and whether they were oral or in writing.

Interrogatory No. 12. It has been stipulated in this case that the reconstruction of the buildings here involved has been delayed by the other defendants with your consent and approval given in or about the month of June, 1950.

(a) State when said consent was given.

(b) Was said consent oral or in writing?

(c) Was said consent embodied in or given pursuant to an agreement?

(d) If it was, state the substance of said agreement, the date it was made, and whether it was oral or in writing.

Interrogatory No. 12. Has any agreement been made by you with the other defendants, or any of them, relative to the application of the proceeds of insurance policies to the reconstruction of the buildings leased by you to them?

Interrogatory No. 13. If your answer to the preceding interrogatory is in the affirmative, state the substance of said agreement, the date it was made, and whether it was oral or in writing.

Interrogatory No. 14. Have the other defendants paid rent to you since the destruction by fire on 8 April, 1949, of the buildings leased by you to them?

Interrogatory No. 15. If your answer to the preceding interrogatory is in the affirmative, state the amount of rent which has been paid.

Dated 9 January, 1951.

BERT W. LEVIT,

DAVID C. BOGERT,

LONG & LEVIT,

By /s/ DAVID C. BOGERT,

Attorneys for Plaintiff and Cross-Defendant, Hardware Mutual Insurance Co. of Minnesota, a corporation.

Affidavit of Service by Mail attached.

[Endorsed]: Filed January 30, 1951.

[Title of District Court and Cause.]

ANSWER TO INTERROGATORIES PROPOUNDED BY PLAINTIFF

State of California,
County of Butte—ss.

Mildred A. Dunwoody, having been duly sworn, makes the following answers to interrogatories propounded to her in the above-entitled case. Her answer to each interrogatory is:

1. Benjamin Unger.

2. Yes.

3. Mr. Unger stated that Montgomery Ward & Company was interested in obtaining the property and erecting a store building thereon, but that it would not accept an assignment of the original lease made on November 1, 1943, between myself as landlord and the Grand Rapids Furniture Company as tenants, which lease was later assigned to defendant herein, H. A. Goldman and H. F. Baruh, and that to secure Montgomery Ward as a tenant certain provisions of the lease would have to be deleted or revised, and Mr. Unger presented to me for my execution that certain agreement referred to herein as "Exhibit B."

4. At first I refused to sign the agreement dated April 16, 1946, (Exhibit "B"); if my recollection serves me right, while this matter was pending a representative of Montgomery Ward sought to interview me, but I refused to see him. Finally, however, after consulting with my attorney, I agreed to sign the agreement of April 16, 1946, which is referred to as "Exhibit B" herein, provided Mr. Goldman and Mr. Baruh signed an agreement which was prepared by my attorney and dated April 23, 1946, and is "Exhibit C"; I delayed signing the agreement "Exhibit B" until Mr. Goldman and Mr. Baruh had signed the agreement of April 23, 1946; these instruments were each acknowledged by me upon April 29, 1946.

5. The negotiations preceding the execution by me of the agreements (Exhibit "B" and Exhibit "C"), were as described in my preceding answer. When "Exhibit B" was presented, I refused to sign it. Mr. Unger pointed out that it was advantageous to have a building such as Montgomery Ward & Company would build located upon my property; I consulted my attorney, Jerome D. Peters, Sr., of Chico, and he suggested that he draw an agreement to be signed by Mr. Goldman and Mr. Baruh, and if it was signed, it would be all right for me to sign Exhibit "B," which agreement to be so drawn would require said parties individually and personally to perform all things required under the original lease of November 1, 1943. The main reason for the request of Mr. Goldman and Mr. Baruh was that in the event the Montgomery Ward building was destroyed by fire, and my building on the premises having been removed to build the Montgomery Ward building, I would have no funds available for rebuilding, and such a provision was most important to me.

6. Yes.

7. I cannot answer this definitely; there was a lapse of a number of days between the time that "Exhibit B" was presented to me for signing, and before I actually signed same; I have a faint recollection that I talked over the telephone concerning the matter with Mr. Baruh, but I cannot be positive of this; however, I did inform Mr. Unger who represented Mr. Baruh and Mr. Goldman in all of

the proceedings involved in these exhibits, that it was my intention that Mr. Goldman and Mr. Baruh should restore the building in the event of destruction by fire. My primary reason for requiring the signing of "Exhibit C" was for this very purpose, but I had in mind also that under the original lease, I could rebuild the building myself in the event of such a loss and use the insurance money recovered from fire policies placed on the buildings by Mr. Baruh and Mr. Goldman.

8. No.

9.

10. Yes, first my attorney wrote, asking them to rebuild, but then their attorney, Mr. Samuels, got in touch with my attorney, Jerome D. Peters, and stated that the Montgomery Ward lease deal showed signs of life again and that a representative from Montgomery Ward was coming out to see him in respect to the matter, and my attorney advised me to delay a demand to rebuild, and my attorney has informed me that he so advised Mr. Samuels.

11. This transaction was correspondence between Mr. Samuels and Mr. Peters, and verbal communications; these occurred toward the end of June, 1950.

12. (a) I believe the latter part of June, 1950.

(b) It was either oral or in the form of letters between counsel for respective parties.

(c) No.

12. I have been requested by Mr. Baruh and Mr. Goldman to apply the proceeds that I may receive from the Hardware Mutual Company's policy on the rebuilding of the destroyed buildings. I have neither told them that I would or would not. My insurance carrier, the Hardware Mutual, tells me in the first place that I haven't any insurance, and then tells me in the second place, that if I do have any insurance, it is something like $7,000.00 worth instead of the face value of the policy, which is $10,000.00; the buildings should be rebuilt; the lease provides that Mr. Goldman and Mr. Baruh will rebuild them. In this suit, however, they are claiming that they are not required to rebuild them. Even if they are required to rebuild them, I know nothing of Mr. Goldman's or Mr. Baruh's financial status. It is obvious that the buildings cannot be rebuilt for near the amount they could have been rebuilt when the fire happened, which was on October 8, 1948. My determination in the matter has not yet been formed and I am awaiting the termination of this proceeding to make a determination. If I have to pursue Mr. Goldman and Mr. Baruh legally and take another couple of years in doing so, it may be that I will take up my rights under the agreement to use the insurance taken on the building in the name of Mr. Goldman, Mr. Baruh and myself, and with it and my own insurance, if I get any, rebuild.

13.

14. Yes, on the real property, that is land.

15. $200.00 per month.

/s/ MILDRED A. DUNWOODY,
MILDRED A. DUNWOODY.

Subscribed and sworn to before me this 23rd day of January, 1951.

/s/ O. E. TRACY,
Notary Public,
Butte County, Calif.

My Commission Expires April 25, 1952.

[Endorsed]: Filed January 29, 1951.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled action came on regularly for trial before the above-entitled court sitting without jury, the Hon. Michael J. Roche presiding, upon the 20th day of February, 1951, in the court room of the above-entitled court, situated in the Post Office Building at 7th & Mission Streets, in the City of San Francisco, State of California; the action came on for trial upon the complaint of plaintiff and the amended answer and cross-complaint of the defendant, Mildred A. Dunwoody, and the amended answer of the defendants, Harold A. Goldman, Myrtle

Goldman, Harold F. Baruh and Doris G. Baruh, and upon the cross-complaint of the defendant, Mildred A. Dunwoody, cross-complainant, and the answer thereto of the plaintiff, Hardware Mutual Insurance Company of Minnesota, a corporation, cross-defendant. The plaintiff and cross-defendant was represented by the law firm of Long & Levit, through David C. Bogert; the defendant and cross-complainant, Mildred A. Dunwoody, was represented by the law firm of Peters and Peters, through Jerome D. Peters, and the defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh, were represented by the law firm of Oscar Samuels and Tevis Jacobs, through Robert Sills; evidence, both oral and documentary, was introduced; theretofore there was filed in the action a "Stipulation to Admit Certain Facts" and a supplement thereto, which are marked Exhibit "1"; the taking of evidence having been completed and the matter having been submitted to the court for its determination, and the court being fully advised in the premises hereby finds the following facts to be true, to wit:

Findings of Fact

I.

That paragraphs I to XIV inclusive of the said "Stipulation to Admit Certain Facts" and the supplement thereto, on file herein, are true, and they are incorporated herein and made a part hereof.

II.

That it was stipulated in open court as a fact that at the time of the destruction of the said buildings by fire, the sound value thereof and their replacement value was in excess of the total amount of fire insurance carried upon said buildings, namely upwards of $46,795.00.

III.

That under the said policy of insurance carried by the defendant and cross-complainant, Mildred A. Dunwoody, with the plaintiff and cross-defendant, which policy was in the sum of $10,000.00, she sustained a total loss.

IV.

That the original lease of the premises involved was dated the first day of November, 1943, and under it the defendant, Mildred A. Dunwoody, leased the premises to the Grand Rapids Furniture Company for a term of fifty years, commencing January 1, 1944; that the interest of the said Grand Rapids Furniture Company, as lessee, was later transferred to the defendants, Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh, and they are the lessees of the premises described therein; as set forth in the "Stipulation of Facts" marked Exhibit "1," an instrument dated April 16, 1946, was entered into between the said Mildred Dunwoody and the said Goldmans and Baruhs, defendants, which purported to delete certain paragraphs from the terms of said original lease there was also an agreement dated April 23, 1946,

entered into between the said Mildred A. Dunwoody, defendant, and the said defendants, Harold A. Goldman and Harold F. Baruh, wherein they individually agreed to be bound by all the terms of the original lease, including those deleted by the agreement of April 16, 1946; that it is the intent of the two agreements said defendants be so bound; both agreements were delivered at one time to the said Goldmans and Baruhs by the said Mildred A. Dunwoody on the express condition that the said defendants were to be so bound; that these were delivered to the said Baruh and Goldman defendants by the defendant, Mildred A. Dunwoody, through one Ben Unger, the agent of said Baruhs and Goldmans, and while he was acting for said defendants within the course and scope of his employment; that they were delivered by letter to said Ben Unger, said agent, with instructions to deliver them only if it was the intent of the said defendant to be so bound; that the said Ben Unger delivered them to said defendants who executed them, and an executed copy of each was delivered by said Ben Unger to said Mildred A. Dunwoody by letter in which Mr. Unger stated that they protected her.

V.

That under the terms of the original lease of November 1, 1943, and in particular, under section 12 thereof, the lessees were obligated in the event the bulidings were destroyed by fire to restore the same at their own expense and without unnecessary delay; said paragraph was one of the paragraphs

deleted by the agreement of April 16, 1946; that it was revived as to the defendants Harold A. Goldman and Harold F. Baruh by the agreement of April 23, 1946; that as set forth in "Stipulation to Admit Certain Facts" the said Baruh and Goldman defendants carried a total fire insurance in the sum of $36,795.00 and by the supplement to "Stipulation to Amend Certain Facts" which is in evidence here with the original, it is stipulated that the said Baruh and Goldman defendants of said insurance have been paid $25,000.00 by the Security Insurance Company, and that said company retained, as provided by its policy, $11,743.89, to be paid to said parties at a later date; that of the $25,000.00 so paid, said Baruh and Goldman defendants expended $1,173.89 to remove the debris upon the property caused by the burned buildings and that the balance of the said $25,000.00 was placed by the parties in a savings account in a bank in San Francisco, to be withdrawn only upon the signatures of Mildred A. Dunwoody and Harold F. Baruh and Harold A. Goldman.

Conclusions of Law

From the foregoing findings of fact, the court concludes:

I.

That the defendant and cross-complainant, Mildred A. Dunwoody, is entitled to a judgment under her cross-complaint against the plaintiff and cross-defendant, Hardware Mutual Insurance Company of Minnesota, a corporation, in the sum of $10-

000.00 plus interest thereon at the rate of 7% per annum from January 21, 1950.

II.

That upon the payment of the foregoing judgment, the plaintiff and cross-defendant is not entitled to subrogate as against the defendants Harold F. Baruh, Doris G. Baruh, Harold A. Goldman or Myrtle Goldman, or any thereof.

III.

That the defendants Harold A. Goldman and Harold F. Baruh are legally bound by and to perform the obligations of the tenants of the premises upon which the buildings were destroyed by fire, and to restore the buildings destroyed by fire as provided in Paragraph 12 of the original lease of November 1st, 1943, and are similarly bound by all paragraphs of said lease.

IV.

That the defendants Mildred A. Dunwoody, Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh shall be entitled to their costs of suit herein incurred.

Dated: April 6th, 1951.

/s/ MICHAEL J. ROCHE,
Chief United States
District Judge.

[Endorsed]: Filed April 6, 1951.

In the Southern Division of the United States District Court for the Northern District of California

No. 29584

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a Corporation,

Plaintiff,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, and DORIS G. BARUH,

Defendants.

MILDRED A. DUNWOODY,

Cross-Complainant,

vs.

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a Corporation,

Cross-Defendant.

JUDGMENT

This cause coming on regularly for trial before the above-entitled court, the Honorable Michael J. Roche presiding without a jury and the said matter being heard and tried upon the complaint of plaintiff and the amended answer and cross-complaint of the defendant and the amended answer of the defendants, Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh, and upon the cross-complaint of the defendant, Mildred A.

Dunwoody, cross-complainant, and the answer thereto of the plaintiff, Hardware Mutual Insurance Company of Minnesota, a corporation, cross-defendant, the plaintiff and cross-defendant being represented by the law firm of Long & Levit through David C. Bogert, Esq.; the defendant and cross-complainant, Mildred A. Dunwoody, being represented by the law firm of Peters & Peters, through Jerome D. Peters, Esq., and the defendants, Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh, being represented by the law firm of Oscar Samuels, through Robert Sills, Esq., and evidence, both oral and documentary being introduced and the matter having been submitted to the court for its decision, and the court having heretofore caused to be signed and filed its Findings of Fact and Conclusions of Law, and by reason thereof and the law,

It is hereby adjudged and decreed as follows, to wit:

I. That the defendant and cross-complainant, Mildred A. Dunwoody, have, and she is hereby granted, judgment against the plaintiff and cross-defendant, Hardware Mutual Insurance Company of Minnesota, a corporation, in the sum of Ten Thousand Dollars ($10,000.00), plus interest thereon at the rate of 7% per annum from January 21, 1950, and until paid, and for her costs of suit hereby taxed at the sum of $20.00.

II. That upon the payment by the plaintiff and cross-defendant, Hardware Mutual Insurance Com-

pany of Minnesota, a corporation, of the said sum of Ten Thousand Dollars ($10,000.00) to defendant and cross-complainant, Mildred A. Dunwoody, as adjudged in the preceding paragraph, said plaintiff and cross-defendant is not entitled to be subrogated to any of the rights of the said Mildred A. Dunwoody or at all, against the defendants Harold F. Baruh, Doris G. Baruh, Harold A. Goldman or Myrtle Goldman, or any thereof.

III. The defendants Harold A. Goldman and Harold F. Baruh are legally bound by and to perfrom the obligations of paragraph 12, and all the provisions of that certain lease dated November 1, 1943, in which the said premises and buildings described in paragraph V of plaintiff's complaint were leased by Mildred A. Dunwoody, defendant and cross-complainant herein, to the Grand Rapids Furniture Company for a period of fifty (50) years from January 1, 1944, and which lease was later and upon April 3, 1945, assigned by the Grand Rapids Furniture Company to the said defendants, Harold F. Baruh and Harold A. Goldman, which said lease is referred to and described in the "Stipulation to Admit Certain Facts" filed herein and marked Exhibit "I," and as provided by the provisions of said paragraph 12, said defendants are obligated to restore the buildings destroyed.

IV. That the defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh do have and recover of and from plaintiff and cross-defendant, Hardware Mutual Insurance

Company of Minnesota, a corporation, their costs and expenses incurred in said action amounting to the sum of $20.00.

Dated: April 6th, 1951.

/s/ MICHAEL J. ROCHE,
Chief U. S. District Judge.

[Endorsed]: Filed April 6, 1951.

Entered in Civil Docket April 9, 1951.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Hardware Mutual Insurance Co. of Minnesota, a corporation, plaintiff and cross-defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from those portions of the final judgment entered in this action on 9 April, 1951, reading as follows:

> "It is hereby adjudged and decreed as follows, to wit:
>
> "I. That the defendant and cross-complainant, Mildred A. Dunwoody, have, and she is hereby granted, judgment against the plaintiff and cross-defendant, Hardware Mutual Insurance Company of Minnesota, a corporation, in the sum of Ten Thousand Dollars ($10,000.00), plus interest thereon at the rate of 7% per annum from January 21, 1950, and until paid,

and for her costs of suit hereby taxed at the sum of $20.

"II. That upon the payment by the plaintiff and cross-defendant, Hardware Mutual Insurance Company of Minnesota, a corporation, of the said sum of Ten Thousand Dollars ($10,000.00) to defendant and cross-complainant, Mildred A. Dunwoody, as adjudged in the preceding paragraph, said plaintiff and cross-defendant is not entitled to be subrogated to any of the rights of the said Mildred A. Dunwoody or at all, against the defendants Harold F. Baruh, Doris G. Baruh, Harold A. Goldman or Myrtle Goldman, or any thereof.

"IV. That the defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh do have and recover of and from plaintiff and cross-defendant, Hardware Mutual Insurance Company of Minnesota, a corporation, their costs and expenses incurred in said action amounting to the sum of $20."

BERT W. LEVIT,

DAVID C. BOGERT,

LONG & LEVIT,

By /s/ DAVID C. BOGERT,

Attorney for Appellant Hardware Mutual Insurance Co. of Minnesota.

[Endorsed]: Filed April 26, 1951.

[Title of District Court and Cause.]

SUPERSEDEAS BOND ON APPEAL

Know All Men by These Presents:

That we, Hardware Mutual Insurance Co. of Minnesota, a corporation, the above-named plaintiff and cross-defendant, as Principal, and Glens Falls Indemnity Co., an insurance corporation organized and existing under the laws of the State of New York, as Surety, are held and firmly bound unto Mildred A. Dunwoody, defendant and cross-complainant, and Harold A. Goldman, Myrtle Goldman, Harold F. Baruh, and Doris G. Baruh, defendants, in the full and just sum of Twelve Thousand Five Hundred Dollars ($12,500.00) to be paid to the said cross-complainant and defendants, their certain attorneys, executors, administrators, or assigns; to which payment to be well and truly made we bind ourselves, our successors and assigns, jointly and severally by these presents.

Sealed with our seals and dated this 19th day of April, 1951.

Whereas, on April 9, 1951, a judgment was rendered in favor of the above-named obligees and against the said Hardware Mutual Insurance Co. of Minnesota, and the said Hardware Mutual Insurance Co. of Minnesota having filed or being about to file in said Court a notice of appeal to reverse the judgment in the aforesaid suit, on appeal to the United States Court of Appeals for the Ninth Circuit; and

Whereas, the said plaintiff and cross-defendant desires a stay of all proceedings in the above-entitled cause until the determination of the said appeal;

Now Therefore, the condition of this obligation is such that if the said Hardware Mutual Insurance Co. of Minnesota, as appellant, shall prosecute its appeal with effect and shall satisfy the said judgment in full together with costs, interest and damage for said delay if said appeal is dismissed or if the judgment is affirmed, and shall satisfy in full such modification of the judgment and costs, interest and damages as may be adjudged and awarded by the appellate court, then this obligation to void; otherwise to remain in full force and effect.

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA,

[Seal] By /s/ P. O. WETTLESON,
Resident Assistant
Secretary.

GLENS FALLS INDEMNITY CO.,

By /s/ DONALD J. MOLLBERG,
Attorney.

The foregoing bond is hereby approved and is to stand as a supersedeas until the final determination of the appeal.

/s/ MICHAEL J. ROCHE,
District Judge.

State of California,
City and County of San Francisco—ss.

On this 19th day of April in the year One Thousand Nine Hundred and Fifty-one before me, Alice E. Lowrie, a Notary Public in and for the said City and County of San Francisco, residing therein, duly commissioned and sworn, personally appeared Donald J. Mollberg, known to me to be the Attorney of the Glens Falls Indemnity Company, the Corporation that executed the within instrument, and known to me to be the person who executed the said instrument on behalf of the Corporation therein named and acknowledged to me that such Corporation executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal in the City and County of San Francisco the day and year in this certificate first above written.

[Seal] /s/ ALICE E. LOWRIE,
Notary Public in and for the City and County of San Francisco, State of California.

My Commission Expires May 23, 1952.

State of California,
City and County of San Francisco—ss.

On this 19th day of April, 1951, before me Josephine Limpert, a Notary Public, in and for the City and County of San Francisco, residing therein, duly commissioned and sworn, personally appeared P. O. Wettleson, known to me to be the Resident Assistant Secretary of Hardware Mutual Insurance

Co. of Minnesota, a corporation, and also known to me to be the person who executed the within instrument on behalf of said corporation, and he acknowledged to me that such corporation executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official Seal at my office in said City and County of San Francisco the day and year in this certificate first above written.

[Seal] /s/ JOSEPHINE LIMPERT,
Notary Public in and for the City and County of San Francisco, State of California.

My Commission Expires September 8, 1954.

[Endorsed]: Filed April 26, 1951.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, do hereby certify that the foregoing documents, listed below are the originals filed in this Court, or true copies of orders entered in this Court, in the above-entitled case and that they constitute the record on appeal herein as designated by the attorneys for the appellant:

Complaint for declaratory relief.

Amended answer of Defendants Harold A. Gold-

man, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh.

Amended answer and cross-complaint of Defendant Mildred A. Dunwoody.

Answer to cross-complaint.

Order that answer to cross-complaint stand as answer to the amended cross-complaint of Mildred A. Dunwoody.

Stipulation to admit certain facts.

Supplement to "Stipulation to admit certain facts."

Interrogatories propounded by plaintiff.

Answer to interrogatories propounded by plaintiff.

Findings of fact and conclusions of law.

Judgment.

Notice of appeal.

Supersedeas bond on appeal.

Designation of contents of record on appeal.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court this 4th day of June, 1951.

C. W. CALBREATH,
Clerk.

[Seal] /s/ C. W. TAYLOR,
Deputy Clerk.

[Endorsed]: No. 12960. United States Court of Appeals for the Ninth Circuit. Hardware Mutual Insurance Co. of Minnesota, a Corporation, Appellant, vs. Mildred A. Dunwoody, Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh, Appellees. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed June 4, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
For the Ninth Circuit

No. 12960

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a Corporation,

Appellant,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, and DORIS G. BARUH,

Appellees.

STATEMENT OF POINTS TO BE RELIED UPON ON APPEAL AND DESIGNATION OF RECORD MATERIAL TO CONSIDERATION OF APPEAL

Now Comes appellant above named and, pursuant to subparagraph 6 of Rule 19 of the Rules of this Court, makes this statement of the points upon which it intends to rely on the appeal herein, and also makes the following designation of the record which it thinks material to the consideration thereof:

I.

Points

1. The court erred in finding and holding that upon payment of $10,000 by appellant to appellee Mildred A. Dunwoody, appellant is not entitled to be subrogated to any of the rights of the said appellee or at all, against the appellees Harold F.

Baruh, Doris G. Baruh, Harold A. Goldman or Myrtle Goldman, or any of them.

2. The court erred in failing to find that the actions of appellee Mildred A. Dunwoody in consenting to and approving the delay by the other appellees in reconstructing the buildings destroyed by fire seriously prejudiced or destroyed appellant's right of subrogation against said other appellees.

3. The court in finding and holding that appellee Mildred A. Dunwoody is entitled to a judgment against appellant in the sum of $10,000 plus interest thereon at the rate of 7% per annum from January 21, 1950.

II.

Designation

Appellant designates the following portions of the record as those which are material to the consideration of this appeal, to wit:

1. Plaintiff's Complaint for Declaratory Relief.
2. Amended Answer of Defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh.
3. Amended Answer and Cross-Complaint of Defendant and Cross-Complainant Mildred A. Dunwoody.
4. Answer to Cross-Complaint.
5. Minute Order made 20 February, 1951, permitting Answer to Cross-Complaint to stand as an Answer to the Amended Cross-Complaint.
6. Stipulation to Admit Certain Facts.

7. Supplement to "Stipulation to Admit Certain Facts."

8. Interrogatories Propounded by Plaintiff to Defendant and Cross-Complainant.

9. Answers to Interrogatories Propounded by Plaintiff.

10. Findings of Fact and Conclusions of Law prepared and entered by the court on 6 April, 1951.

11. Judgment, entered 6 April, 1951.

12. Notice of Appeal, with date of filing.

13. Supersedeas Bond on Appeal, with date of filing.

14. Designation of Contents of Record on Appeal.

Certificate of clerk. [In pencil.]

Dated: San Francisco, California, 7 June, 1951.

BERT W. LEVIT,

DAVID C. BOGERT,

LONG & LEVIT,

By /s/ DAVID C. BOGERT,
Attorneys for Appellant.

Affidavit of Service by Mail attached.

[Endorsed]: Filed June 7, 1951.

No. 12,960

IN THE

United States Court of Appeals

For the Ninth Circuit

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a corporation,
Appellant,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, and DORIS G. BARUH,
Appellees.

APPELLANT'S BRIEF.

BERT W. LEVIT,
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Attorneys for Appellant.

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No. 12,960

IN THE

United States Court of Appeals

For the Ninth Circuit

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a corporation,
Appellant,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, and DORIS G. BARUH,
Appellees.

APPELLANT'S BRIEF.

JURISDICTIONAL STATEMENT.

Appellant (plaintiff) commenced this action in the United States District Court for the Northern District of California, Southern Division, by complaint for declaratory relief (R 3-7), filed pursuant to the Federal Declaratory Judgment Act (28 *USC* 2201). The complaint alleges (R 3-4) and the answers admit (R 8, 27) that there is complete diversity of citizenship between appellant and each appellee, and that the amount in controversy between appellant and each appellee exceeds the sum of $3000. The appeal is from

a final judgment, rendered after trial, adjudging that appellee Dunwoody recover $10,000 from appellant, and that appellant is not entitled to be subrogated to the rights of said appellee against the other appellees upon the payment of said sum (R 82-3).

Jurisdiction of this cause is conferred on the District Court by 28 *USC* 1332. Jurisdiction to review the judgment herein is conferred upon this Court by 28 *USC* 1291 and 1294.

STATEMENT OF CASE.

Appellant is an insurance company. It issued to appellee Dunwoody a policy of fire insurance covering on two buildings in Chico, California, in the amount of $10,000 (R 38); the policy is attached as Exhibit "A" to the factual stipulation entered into by the parties (R 37, 39, 45). These buildings were totally destroyed by fire on 8 April 1949 (R 41), during the term of the policy.

Appellee Dunwoody was the owner of the buildings. She had leased them to Grand Rapids Furniture Company for 50 years commencing 1 January 1944, by written lease dated 1 November 1943 (R 77). The interest of the lessee was transferred to the other appellees as successor lessees, and these appellees continued as and still are lessees of the premises in question (R 77). By certain supplemental agreements entered into between appellee Dunwoody as owner and lessor, and the remaining appellees as lessees, appel-

lees Myrtle Goldman and Doris Baruh were purportedly released from some of the terms of the original lease, but appellees Harold Goldman and Harold Baruh remained bound by all of the terms of the original lease (R 18-27, 77-9).

The lease (Paragraph 12) provided that in the event of a destruction of the demised premises by fire, "the same shall be restored by the Tenant at its own expense without unnecessary delay" (R 40). The trial court found that this obligation to rebuild was obligatory upon the lessees, and in particular upon appellees Harold Goldman and Harold Baruh (V; R 78-9); and the trial court made the following conclusion of law thereon (III; R 80):

> "That the defendants Harold A. Goldman and Harold F. Baruh are legally bound by and to perform the obligations of the tenants of the premises upon which the buildings were destroyed by fire, and to restore the buildings destroyed by fire as provided in paragraph 12 of the . . . lease . . ."

The judgment similarly provides (III; R 83):

> "The defendants Harold A. Goldman and Harold F. Baruh are legally bound by and to perform the obligations of paragraph 12, and all the provisions of that certain lease dated November 1, 1943, in which the said premises and buildings . . . were leased by [appellee] Dunwoody . . ., to the Grand Rapids Furniture Company for a period of fifty (50) years from January 1, 1944, and which lease was later . . . assigned by the Grand Rapids Furniture Company to [appel-

> lees] Harold F. Baruh and Harold A. Goldman . . ., and as provided by the provisions of said paragraph 12, said defendants are obligated to restore the buildings destroyed."

At the time of the trial replacement of the buildings had not yet been undertaken, this having been delayed by the lessee appellees with the consent and approval of appellee Dunwoody, the owner (R 42).

Appellant's complaint for declaratory relief asked the court to determine whether appellee Dunwoody had suffered any loss, in view of the lessees' obligation to rebuild (IX; R 6); and asserted that if the court should determine that appellee Dunwoody did suffer a loss under the policy which appellant must pay, appellant "will then be subrogated" to appellee Dunwoody's rights against the other appellees under the lease (X; R 6).

The complaint also contains allegations concerning a policy of insurance issued by another insurer and suggests that a question of apportionment of loss might arise as between that insurer and appellant (VII, XI; R 5-7). It subsequently developed by stipulation, however, that the loss by fire was in excess of the total amount of fire insurance. This eliminated any question of apportionment, and the other insurer was dismissed from the case.

The trial court adjudged: (1) That appellee Dunwoody should have judgment against appellant for $10,000, the full face amount of the policy of insurance; (2) That appellees Harold Goldman and Harold

Baruh are obligated to restore the buildings destroyed; and (3) That appellant "is not entitled to be subrogated to any of the rights of the said Mildred A. Dunwoody or at all, against" the other appellees (R 82-3).

SPECIFICATION OF ERRORS.

I. The trial court erred in finding and holding that upon the payment of $10,000 by appellant to appellee Dunwoody pursuant to the judgment of the court, appellant is not entitled to be subrogated *pro tanto* to the rights of appellee Dunwoody against appellees Harold Goldman and Harold Baruh under the lease whereby the last named appellees are obligated to restore the premises.

SUMMARY OF ARGUMENT.

I. Denial of subrogation to appellant violates the fundamental principle that a fire insurance policy is a contract of indemnity.

II. Subrogation of an insurer is not limited to those rights of insured that arise from the tort of a third party; it applies equally to cases where the insured's rights against a third party arise from a contract obligation.

III. An insurer's right of subrogation arises by operation of law and is not dependent upon any express provision therefor in the policy.

IV. Lessee appellees are not entitled to the benefit of appellant's insurance payment to appellee Dunwoody.

ARGUMENT.

I.

DENIAL OF SUBROGATION TO APPELLANT VIOLATES THE FUNDAMENTAL PRINCIPLE THAT A FIRE INSURANCE POLICY IS A CONTRACT OF INDEMNITY.

The trial court decreed that the lessee appellees were obligated to restore the buildings by reason of the terms of their lease. Such restoration will, of course, furnish appellee Dunwoody, the owner, with full indemnification for the loss of the buildings by fire. Indeed, it will give the owner more than full indemnity, because she will have had old buildings replaced by new. In addition, the judgment gives to the owner a $10,000 payment from appellant for the same fire loss.

Sections 22 and 23 of the *California Insurance Code* specify what is indeed the accepted rule of law that a contract of insurance is a contract of indemnity.

> "Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event." (s 22)
>
> "The person who undertakes to indemnify another by insurance is the insurer, and the person indemnified is the insured." (s 23)

The California courts and this Court have consistently limited the right of recovery under a fire

insurance policy to indemnity only, and nothing more.

Davis v Phoenix Ins Co (1896) 111 C 409, 43 P 1115;

Sievers v Union Assur Soc (1912) 20 CA 250, 128 P 771;

Smith v Jim Dandy Markets (CCA 9, 1949) 172 F2 616.

In the last cited case, this Court said (p 618):

> "It is argued that . . . Smith had an insurable interest in the building because of his lien thereon for the payment of the balance of the purchase price, and therefore should recover on his policy . . . This argument fails because, regardless of Smith's interest in the building, he suffered no loss from its destruction. Under California law, which we are required to follow, a fire insurance policy is a personal indemnity contract and a showing of pecuniary damage is prerequisite to recovery thereon."

In view of the fact that the obligation to restore the buildings had not been performed by the lessees at the time of the trial, we do not complain of that part of the judgment which requires the insurer to pay the amount of its policy to appellee Dunwoody. However, since the contract *is* one of indemnity the court should have included in the judgment a declaration that upon full restoration of the buildings appellant would be entitled to a return of the amount so paid, and that in the event of a failure upon the part of lessees to fulfill their obligation to restore the buildings appellant would be entitled to be subrogated to appellee

Dunwoody's right to enforce this obligation—such subrogation to be *pro tanto* to the extent of the amount paid by appellant and subject to the prior right of appellee Dunwoody to have full indemnification for her loss.[1]

II.

SUBROGATION OF AN INSURER IS NOT LIMITED TO THOSE RIGHTS OF INSURED THAT ARISE FROM THE TORT OF A THIRD PARTY; IT APPLIES EQUALLY TO CASES WHERE THE INSURED'S RIGHTS AGAINST THE THIRD PARTY ARISE FROM A CONTRACT OBLIGATION.

> "Insurer's right to subrogation is not limited to cases where the liability of the third person is founded in tort, but any right of insured to indemnity will pass to insurer on payment of the loss, including rights under contracts with third persons . . ." 46 *CJS* 154-5; Insurance, s 1209, n 17-20.

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[1]The prayer of the complaint (R 7) merely asks that judgment be entered against lessee appellees in the amount of any judgment entered against plaintiff in favor of appellee Dunwoody. However, the prayer also contains the usual general prayer for "other and further relief", and it is well settled that this is sufficient to authorize such declaration and decree as is appropriate under the pleadings and the issues tried.

FRCP, Rule 54(c);

Borchard, Declaratory Judgments (2d Ed), ch X, p 425, 426-7;

Anderson, Declaratory Judgments, s 97, p 256 ff.

The complaint (X, R 6) sufficiently asserts the right of appellant to be subrogated to appellee Dunwoody's rights under the lease against the lessee appellees; and the findings and conclusions of the trial court (R 75-80) as well as the judgment (R 81-4) show that the case was tried and decided upon that theory.

The rule is illustrated by cases where subrogation has been allowed to an insurer against a common carrier responsible to the insured under the contract of carriage for the loss of the insured property.

Mobile etc R Co v Jurey (1883) 111 US 584, 4 SCt 566, 28 LEd 527, 529;

Garrison v Memphis Ins Co (1856) 19 How 312, 15 LEd 656;

Liverpool etc Co v Phenix Ins Co (1888) 129 US 397, 9 SCt 469, 32 LEd 788, 799;

Phoenix Ins Co v Erie etc Co (1885) 117 US 312, 6 SCt 750, 29 LEd 873, 878-80;

Hall v Nashville etc R Co (1871) 13 Wall 367, 20 LEd 594, 596-7;

6 *Appleman, Insurance Law,* s 4056, p 538 ff.

The rule is also illustrated by those cases which subrogate an insurer under a single-interest[2] policy issued to a mortgagee, to the latter's right against the mortgagor to repayment of the mortgage debt.

Fields v Western etc Ins Co (NY 1943) 48 NE2 489, 146 ALR 434, 438:

"Of course if a policy is issued to the mortgagee, procured by him and so written as to cover his interest only, then the owner can claim no rights under it and the insurer may be subrogated as against the owner-mortgagor. Such situations are dealt with in cases like *Excelsior*

[2]We use the term "single-interest" to distinguish those cases in which the mortgagor is named in the policy along with the mortgagee or where the mortgagor himself has obtained the policy from the insurer and paid the premium on it, from cases where the mortgagee acts independently to procure insurance to protect his own insurable interest without naming the mortgagor as a party insured.

F Ins Co v Royal Ins Co of Liverpool, 55 NY 343, 14 AmRep 271: 'It is settled that when a mortgagee, or one in like position toward property, is insured thereon at his own expense, upon his own motion and for his sole benefit, and a loss happens to it, the insurer, on making compensation, is entitled to an assignment of the rights of the insured.' "

Baker v Monumental etc Assn (WVa 1905) 52 SE 403, 3 LRANS 79, 112 ASR 996;

Milwaukee etc Ins Co v Ramsey (Or 1915) 149 P 542, LRA 1916A 556, 558, AnnCas 1917B 1132 (and Annotation, p 1135).

The carrier and mortgagee cases are merely illustrative, and the rule of subrogation[3] is by no means limited to these situations.

In *Automobile Ins Co v Union Oil Co* (1948) 85 CA2 302, 193 P2 48, a fire insurer was subrogated to the cause of action of its insured against a manufacturer of floor cleaning compound, where the fire was caused by breach of an implied warranty in the contract of sale of the compound that it was noninflammable.

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[3] *Western Casualty etc Co v Meyer* (Ky 1946) 192 SW2 388, 164 ALR 769, 777:

"From time immemorial it has been pointed out that, when not depending on express agreement, the principle of subrogation is a principle of equity—of compelling the ultimate discharge of an obligation by him who in good conscience ought to pay it to him who has done so for the obligor, unless he was an intermeddler or volunteer. It is closely akin to, if not a part of, the equitable principle of restitution and unjust enrichment . . . Equity is the same everywhere. The traditional principles . . . are universal in English and American jurisprudence."

In *Chicago etc R Co v Pullman etc Co* (1890) 139 US 79, 11 SCt 490, 35 LEd 97, the Pullman company had leased cars to the railroad company under a lease which provided that the lessee must repair all damage caused by accident or casualty to the leased cars. One car was destroyed by fire. Pullman's insurance carriers paid the loss to Pullman, and the latter then filed suit against the lessee for the benefit of the insurance companies. It was held that the insurance payment did not inure to the benefit of the lessee, and that the insurance company was entitled to subrogation. The Supreme Court said (35 LEd, 101):

> "The acceptance of a given amount from the insurance companies in full discharge of their liability did not affect the right of the plaintiff to recover from the Railroad Company the whole amount of the loss for which the latter was responsible under its contract. The plaintiff could recover only one satisfaction for the loss; and if the amount recovered from the Railroad Company, increased by the sum collected from the insurance companies, was more than sufficient for its just indemnity, the excess would be held by it in trust for the insurance companies . . . 'The general rule of law . . . is that, where there is a contract of indemnity . . . and a loss happens, anything which reduces or diminishes that loss reduces or diminishes the amount which the indemnifier is bound to pay; and if the indemnifier has already paid it, then, if anything which diminishes the loss comes into the hands of the person to whom he has paid it, it becomes an equity that the person who has already paid the full indemnity is entitled to be recouped by having that amount back.' "

Vahlsing Inc v Hartford F Ins Co (Tex 1937) 108 SW2 947 was a similar case where the defendant had leased railroad cars under a lease agreement which required it to pay for any fire damage to the cars. A loss was paid by lessor's insurance carrier, and the insurer then sued the lessee by way of subrogation. The lessee challenged the right of the insurer to recover, in the absence of pleading and proof that the fire was caused by lessee's negligence. Judgment for the insurer was upheld on appeal, on the ground that the insurer was entitled to recover upon lessee's contractual liability to the insured lessor.

The underlying basis for extending the right of subrogation to contract cases was well stated by Lord Justice Brett many years ago in *Castellan v Preston* (1883) 11 QBD 380, 386, 388:

> "The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified. That is the fundamental principle of insurance, and if ever a proposition is brought forward which is at variance with it, that is to stay, which either will prevent the assured from obtaining a full indemnity, or which will give to the assured more than a full indemnity, that proposition must certainly be wrong."
>
> "Now it seems to me that in order to carry out the fundamental rule of insurance law, this doc-

trine of subrogation must be carried to the extent which I am now about to endeavour to express, namely, that as between the underwriter and the assured the underwriter is entitled to the advantage of every right of the assured, whether such right consists in contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted on or already insisted on, or in any other right, whether by way of condition or otherwise, legal or equitable, which can be, or has been exercised or has accrued."

In *Darrell v Tibbitts* (1878) 5 QBD 560, a tenant leased a house from the owner under a lease which required him to repair it. The house was destroyed by an explosion. The owner collected under his insurance policy, and the tenant subsequently restored the house. The insurer then sued to recover the money it had paid to the owner. Judgment in favor of the owner was reversed on appeal. Lord Justice Brett made a statement in the opinion peculiarly applicable to the present case (p 561):

"It seems to me . . . that if the tenants had not repaired the damage, and had declined to do so, the insurance company would have been bound to pay the landlord who had insured with them, but would have had a right to bring in his name an action against the tenants, and recover from the tenants what they had paid to the landlord; in other words, a policy of fire insurance is a contract of indemnity . . ."

See, also:

Nashville Industrial Corp v US (1930) 69 Ct Cl 443;

Continental Ins Co v Bahcall Inc (DC Wis, 1941) 39 FS 315;

Regan v NY etc R Co (Conn 1891) 22 A 503, 25 ASR 306, 314-319;

46 *CJS* 178; *Insurance*, s 1211, n 29-31;

8 *Couch, Cyclopedia of Insurance Law* 6645;

5 *Joyce on Insurance* (2d Ed) 5913.

III.

AN INSURER'S RIGHT OF SUBROGATION ARISES BY OPERATION OF LAW AND IS NOT DEPENDENT UPON ANY EXPRESS PROVISION THEREFOR IN THE POLICY.

The California cases have uniformly held that the right of an insurer to subrogation arises by operation of law, and does not depend upon any language in the insurance policy.

Offer v Superior Court (1924) 194 C 114, 228 P 11, 12-13;

Dibble v San Joaquin Light & Power Co (1920) 47 CA 112, 190 P 198;

Automobile Ins Co v Union Oil Co (1948) 85 CA2 302, 193 P2 48;

14 *CalJur* 592; Insurance, s 127.

As was said in *Federal Ins Co v Detroit F&M Ins Co* (CCA 6, 1913) 202 F 648, 651:

"Most of the insurers obtained subrogation receipts from the owner upon paying their shares of its loss, some of which in terms provided for full subrogation, and others 'to the extent only and as provided in' the policies, although the

policies do not appear to have contained any provision for subrogation. However we do not regard this as important, nor do counsel for either side, because it is settled that such provisions are not necessary. The right of subrogation arises from the very nature of the contract of insurance as a contract of indemnity. (Cits)"

See, also:[4]

46 *CJS* 154; Insurance, s 1209, n 8;

Brown v Merchants Marine Ins Co (CCA 9, 1907) 152 F 411, 413;

National etc Ins Co v US (CA 9, 1948) 171 F2 206, 207;

National Garment Co v NY etc R Co (CA 8, 1949) 173 F2 32, 37.

The insurance policy in the case at bar contains the following provision (R 47; photostat of policy, lines 144-6):

"Subrogation. If this company shall claim that the fire was caused by the act or neglect of any person or corporation, this company shall, on payment of the loss be subrogated to the extent of such payment to all right of recovery by the insured for the loss resulting therefrom, and such right shall be assigned to this company by the insured on receiving such payment."

It is clear that this provision relates only to subrogation against tort feasors or wrongdoers, and has

[4]Many of the cases cited in the immediately preceding subdivision of this brief are also authority upon this point.

no application to the instant situation. In the trial court appellees argued[5] that this paragraph had the effect of limiting the insurer's right of subrogation to cases comprehended by its provisions, namely, to tort cases. Appellees cited and relied upon the case of *Merchants Fire Assur Corp v Hamilton Co* (RI 1949) 69 A2 551.

The *Merchants* case, however, did not hold that the right of subrogation was limited to tort cases. It merely held that when the insurer claimed subrogation against a tort feasor under a policy containing a subrogation clause similar to the one in the policy here, the provisions of the clause must be complied with and the insurer must assert its claim of subrogation not later than the time it pays the loss; the court held that the insurer had waived its right of subrogation because it had not done this. The holding is correct. The policy expressly provided for subrogation in tort cases, and those provisions were doubtless intended to be the measure of that right.

It is quite another thing to say (as appellees argued) that because a policy of insurance specifically provides for subrogation against tort feasors (as fire policies generally do), no subrogation *except against tort feasors* will be permitted to the insurer. Where, as here, the subrogation claimed by the insurer arises from contract rather than from tort liability, the most that can be said is that the policy is silent upon the subject and that subrogation should be granted or

[5]We believe that the trial court accepted this argument.

denied under the general equitable principles applicable under the facts of the case.

The authorities support this view.

The Rhode Island court in the *Merchants* case relied upon the leading case of *Fire Assn v Schellenger* (NJ 1915) 94 A 615, in support of its position. It also cited two Georgia cases. All of the cases cited by the court involved subrogation against tort feasors. Yet in both New Jersey and Georgia, the right of an insurer to subrogate against a third party whose liability is founded in *contract* has been upheld.

Leyden v Lawrence (NJ 1911) 81 A 121 (aff'd 85 A 1134);

Gainesville etc Bank v Martin (Ga 1939) 1 SE2 636.

In *Fields v Western etc Ins Co* (NY 1943) 48 NE2 489, 146 ALR 434, the New York Court of Appeals was dealing with subrogation of a fire insurer to the rights of its insured under a conditional sales contract covering the insured property. The court treated the policy as though it contained no subrogation clause at all, because the subrogation clause which it did contain was inapplicable to the situation with which the court was dealing.

IV.

LESSEE APPELLEES ARE NOT ENTITLED TO THE BENEFIT OF APPELLANT'S INSURANCE PAYMENT TO APPELLEE DUNWOODY.

Paragraph 12 of the lease (R 40-1) obligates lessee appellees to restore the premises damaged or destroyed by fire at their own expense. It further provides that lessee appellees must keep the premises insured against loss by fire by policies of fire insurance naming both the lessees and the owner (appellee Dunwoody).[6] Such a policy was the one issued by Security Insurance Company, referred to in the complaint (VII; R 5), in the answer of lessee appellees (IV; R 11),[7] and in the stipulation of facts (VII; R 41-2).

The same paragraph of the lease also provides that if the lessees carry the required insurance, the owner shall not carry

> "any additional or other fire insurance covering any interest in the demised premises without the knowledge and consent of the Tenant, but if the Landlords shall desire to carry additional insur-

---

[6] "* * * The Tenant covenants and agrees that it, the Tenant, shall at all times during the term hereof and at its own expense keep any and all buildings or improvements now upon or hereafter constructed or placed upon said premises, insured against loss or damage by fire in an amount equal to eighty (80) per cent of the full insurable value thereof above the foundation walls. All such policies of insurance shall be payable to the Landlords and Tenant as their interest may appear * * *. * * * The Landlords shall be furnished with the usual certificates from insurance companies showing the existence of such policies. In case of loss, the Tenant is hereby authorized to adjust the loss and execute proofs thereof in the names of both the Tenant and the Landlords. * * *"

[7] The answer of appellee Dunwoody admits the allegations of paragraph VII of the complaint (I; R 27).

ance and request the Tenant to consent thereto, its consent shall not be unreasonably withheld . . ."

Appellee Dunwoody procured appellant's policy under this provision of the lease, insuring exclusively her own interest in the premises as owner; it was, therefore, a single-interest policy. This is clear from the policy itself. It is also clear from the allegations of the answers filed by appellees:

"* * * This defendant Mildred A. Dunwoody sought and received the consent of the defendants, Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh, to carry insurance upon the said building or buildings; and that pursuant to said consent this defendant Mildred A. Dunwoody *insured her interest as owner of said property* with said plaintiff and which insurance was covered and evidenced by plaintiff's said policy No. 4-24777." (Answer of appellee Dunwoody, III; R 30.)

"* * * Said defendant Mildred A. Dunwoody sought and received the consent of these defendants to carry insurance upon the said building or buildings in addition to the insurance thereon theretofore effected by these defendants and then in effect and in effect at the time of said fire, and that pursuant to said consent said defendant Dunwoody *insured her interest as owner of said property* with said plaintiff and which insurance was covered and evidenced by plaintiff's said policy No. 4-24777." (Answer of lessee appellees, III, R 11.)

Despite these undisputed facts, lessee appellees took the position at the trial, and were sustained in that position by the judgment of the court, that the proceeds of appellant's policy inured to their benefit and were to be applied to the cost of restoration of the burned buildings in satisfaction, *pro tanto,* of their obligation under the lease to restore the premises at their own expense. In this connection, an interrogatory propounded by appellant to and answered by appellee Dunwoody is of interest (R 69, 74):

> "Interrogatory No. 12. Has any agreement been made by you with the other defendants, or any of them, relative to the application of the proceeds of insurance policies to the reconstruction of the buildings leased by you to them?"
>
> "12. I have been requested by Mr. Baruh and Mr. Goldman to apply the proceeds that I may receive from [appellant's] policy on the rebuilding of the destroyed buildings. I have neither told them that I would or would not . . . The buildings should be rebuilt; the lease provides that Mr. Goldman and Mr. Baruh will rebuild them. In this suit, however, they are claiming that they are not required to rebuild them . . ."[8]

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[8]As has been noted, the trial court concluded that appellees Harold Goldman and Harold Baruh were obligated by the lease to restore the buildings. (Findings of Fact, V, R 78-9; Conclusions of Law, III, R 80; Judgment, III, R 83.)

The judgment appealed from should be reversed.

Dated, San Francisco, California,
4 September 1951.

Respectfully submitted,
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Attorneys for Appellant.

No. 12,960

IN THE

United States Court of Appeals

For the Ninth Circuit

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a corporation,
Appellant,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, and DORIS G. BARUH,
Appellees.

BRIEF OF APPELLEES, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH AND DORIS G. BARUH.

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No. 12,960

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JURISDICTION.

Appellant alleged (R. 3-4) and appellees Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh (hereinafter collectively referred to as lessee appellees) and appellee Dunwoody (hereinafter referred to as Dunwoody) admitted (R. 8, 27) that the parties hereto are citizens of different states and that the amount in controversy is in excess of

$3,000.00, exclusive of interest and costs. It is upon this basis that the District Court of the United States for the Northern District of California, Southern Division, had jurisdiction to hear this case under the Federal Declaratory Judgment Act (28 U.S.C. Section 2201).

This Court has jurisdiction to review the decision of said Court under 28 U.S.C. Sections 1291 and 1294.

STATEMENT OF THE CASE.

Practically all of the facts in this case were presented to the District Court by stipulation of the parties hereto (R. 37-66). In its statement of the case appellant has attempted to present a concise statement of these facts. In so doing appellant has omitted therefrom certain facts which are essential to the determination of the issue involved. These facts are as follows:

(1) The only subrogation clause contained in the policy of fire insurance issued by the appellant to Dunwoody, which was the California Standard Form Fire Insurance Policy then in effect, reads as follows:

> "SUBROGATION. If this company shall claim that the fire was caused by the act or neglect of any person or corporation, this company shall, on payment of the loss be subrogated to the extent of such payment to all right of recovery by the insured for the loss resulting therefrom, and such right shall be assigned to this company by the

insured on receiving such payment." (R. 38, 47, lines 144-146).

(2) The fire which, on April 8, 1949, totally destroyed the buildings covered by said policy was due to causes unknown (R. 41).

(3) At the time of said destruction of said buildings, the lessee appellees were, and they still are, successor lessees of the premises upon which said buildings were located under a lease wherein Dunwoody is the lessor (R. 39). Paragraph 12 of said lease reads in part as follows:

> "12. Should the whole or any part of any building or buildings at any time standing on the demised premises be partially or totally destroyed by fire after the commencement of the term hereof, the same shall be restored by the Tenant at its own expense without unnecessary delay.
>
> * * * * * * *
>
> "Notwithstanding anything else herein contained to the contrary, if the premises or a portion thereof be damaged by fire, upon the payment of the insurance by the insurance company of the loss to the parties hereto as their interests may appear, all of such payment may be used by the Landlord for the purpose of restoring the portion damaged if the Landlord desires" (R. 40-41).

(4) At the time of said fire there was in full force and effect a policy of fire insurance issued by the Security Insurance Company of New Haven, in the amount of $36,795.00, covering the same premises

covered by the policy of fire insurance issued by appellant to Dunwoody. The insured named in said policy were appellees Harold F. Baruh and Harold A. Goldman and/or Dunwoody. Loss under said policy was to be adjusted with and payable to said appellees Harold F. Baruh and Harold A. Goldman (R. 41-42). After said fire said Security Insurance Company admitted liability in full under said policy of insurance and paid thereunder to appellees Harold F. Baruh and Harold A. Goldman the sum of $25,000.00, and retained, as provided by the depreciation endorsement clause contained in said policy, the sum of $11,743.89 to be paid to said parties when said buildings are rebuilt; that of the $25,000.00 paid to the appellees Harold F. Baruh and Harold A. Goldman they expended the sum of $1173.89 to remove the debris upon the property caused by the burned buildings and the balance, at the request of Dunwoody, was placed by said appellees Harold F. Baruh and Harold A. Goldman in a savings account in a bank in San Francisco, to be withdrawn only upon the signatures of Dunwoody and appellee Harold F. Baruh or appellee Harold A. Goldman (R. 65-66).

Appellant in its complaint prayed as follows:

"(1) That the Court adjudge that the plaintiff is not liable to defendant Mildred A. Dunwoody in any amount whatsoever;

(2) That should the Court decree that plaintiff is liable to defendant Mildred A. Dunwoody, the Court will determine the amount of said liability

and enter judgment against defendants Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh for said amount.

(3) * * * * * * *

(4) * * * * * * *"

(R. 7).

The Court found in favor of all of the appellees and adjudged that Dunwoody is entitled to recover from appellant the sum of $10,000.00 and that upon payment of said sum to Dunwoody appellant is not entitled to be subrogated to any of the rights of Dunwoody against lessee appellees (R. 82-83).

Appellant now concedes (Br. 7) that insofar as said judgment requires the payment by appellant of said sum of $10,000.00 to Dunwoody and holds that upon said payment appellant is not entitled to judgment for said amount against the lessee appellees, said judgment is correct. Appellant now contends (Br. 7) that the Court "should have included in the judgment a declaration that upon full restoration of the buildings appellant would be entitled to a return of the amount so paid, and that in the event of a failure upon the part of lessees to fulfill their obligation to restore the buildings appellant would be entitled to be subrogated to appellee Dunwoody's right to enforce this obligation—such subrogation to be *pro tanto* to the extent of the amount paid by appellant and subject to the prior right of appellee Dunwoody to have full indemnification for her loss" (Br. 7-8).

In this brief we will confine ourselves to answering this contention so far as it concerns the lessee appellees.

QUESTION PRESENTED.

Upon payment of the sum of $10,000.00 by appellant to Dunwoody under the policy of fire insurance issued by it to her, is appellant entitled to be subrogated to the right of Dunwoody under the aforesaid lease to have the lessee appellees rebuild the buildings destroyed by fire?

SUMMARY OF ARGUMENT.

Since appellant is no longer seeking a monetary judgment against lessee appellees as prayed for in its complaint, but now is only seeking to be subrogated to the right of Dunwoody to have the lessee appellees rebuild the buildings destroyed by fire, and since the lessee appellees do not question their obligation to rebuild said buildings, it might appear, at first blush, that the case has lost all importance to the lessee appellees. However, the only person to whom lessee appellees are so obligated is Dunwoody and the lessee appellees insist that no additional person be given the right to interfere in the performance, or non-performance, or any negotiations in relation to, or any adjustment of, said obligation. That the lessee appellees have the right to so insist will be evident from our argument wherein we will show the following:

1. That this Court and the Supreme Court of the State of California have each recognized and applied the doctrine that, upon payment of the loss under a policy, an insurer does not become subrogated to the rights of the insured under a contract with a third party unless the loss insured against is a debt for which such third party is primarily liable and the insurer is secondarily liable.

2. That in the instant case there is no debt for which the lessee appellees are primarily liable and the appellant is secondarily liable because the appellant insured the buildings destroyed by fire and not the obligation of lessee appellees under their lease with Dunwoody to rebuild said buildings.

3. That the subrogation clause in the policy issued by appellant to Dunwoody limited appellant's right of subrogation to cases where appellant claims that the fire was caused by the act or neglect of a third person, which is not the situation in the instant case where all parties have agreed that the fire which destroyed said buildings was due to causes unknown.

4. That since the trial Court rendered judgment in favor of appellees and against appellant, appellant has no right to claim in this Court relief not prayed for in its complaint.

ARGUMENT.

Admittedly, the policy of fire insurance issued by the appellant to Dunwoody does not contain any provision granting the appellant the right of subrogation to contract rights belonging to Dunwoody (Br. 16). Appellant's argument is based upon its contentions that (1) upon payment of the loss under a policy, an insurer in every instance becomes subrogated to the rights of the insured under contracts with third parties and (2) said right of subrogation arises by operation of law and is not dependent upon any express provision therefor in the policy (Br. 14-17).

It is our contention that (1) where, as in the instant case, there is no primary liability on the part of such third parties for the loss insured against, the insurer is not entitled to be subrogated to the rights of the insured under a contract with such third parties, and (2) the right of subrogation which arises by operation of law may be limited by a provision inserted in the policy such as the subrogation clause contained in the policy issued by appellant to Dunwoody.

I.

UPON PAYMENT OF THE LOSS UNDER A POLICY, AN INSURER DOES NOT BECOME SUBROGATED TO THE RIGHTS OF THE INSURED UNDER A CONTRACT WITH A THIRD PARTY UNLESS THE LOSS INSURED AGAINST IS A DEBT FOR WHICH SUCH THIRD PARTY IS PRIMARILY LIABLE AND THE INSURER IS SECONDARILY LIABLE.

The doctrine that an insurer is not entitled to be subrogated to the rights of the insured under a con-

tract with a third party unless the loss insured against is a debt for which such third party is primarily liable and the insurer is secondarily liable has been recognized and applied in the following two cases wherein the Courts denied the insurer the right to be subrogated to the contract rights of the insured under a lease with a third party.

In *Plate Glass Underwriters' Mutual Insurance Co. v. Ridgewood Realty Co.* (1925), 219 Mo. App. 186, 269 S.W. 659, plaintiff insurance company insured a tenant against breakage of plate glass. Plaintiff replaced some plate glass which had been blown out by a windstorm. Subsequently it discovered that the insured was a tenant under a lease which required the lessor to repair the damage done. Plaintiff sought to recover from the landlord the amount it had expended in replacing the glass on the theory that it had only agreed to indemnify the tenant against the loss of damage in question; that by the terms of the lease such loss was primarily the loss of the landlord and should have been borne by it; and that it was subrogated to the rights of the insured under the subrogation clause in the policy which provided that the insurer upon payment of a loss was entitled to be subrogated to all rights of the assured against any person as respects such loss to the extent of its interest. In holding that the insurer by paying for the repairs did not become subrogated to the rights of the tenant against the landlord, the Court said at page 662:

> "But we do not think any rights of subrogation exist in this case. Subrogation is a child of equity,

which in later years has grown into and become a principle of law; but its origin or basis is in the nature of things, i.e., it grows out of natural justice demanded by the facts of the situation. For instance, if one secondarily liable for a debt pays it, he is entitled as against the debtor who is primarily liable to be subrogated to the creditor's rights, and such right of subrogation arises, by operation of law, out of that situation with or without any agreement to that effect. Loewenstein v. Queen Ins. Co., 227 Mo. 100, 127 S.W. 72. Now, the insurance company in the case at bar did not agree to insure or guarantee to the insured the payment of any debt, or the performance of any obligation on the part of insured's landlord. It merely agreed to insure the plate glass, i.e., the property itself, for a cash consideration, to wit, the premiums paid by insured. The insurance contract was one solely between the two parties thereto, and the insurance company only paid what it contracted primarily to do; but now, notwithstanding it still retains the premiums or the benefit of its contract, it seeks reimbursement from the landlord on the basis that the latter, under a wholly separate and independent contract should have done so. We see no basis of subrogation arising out of the circumstances herein, and are of the opinion that the subrogation clause in the insurance contract only applies to circumstances in which the law creates the right of subrogation. The plaintiff insured the property itself, not a debt due the tenant. Havens v. Germania Ins. Co., 135 Mo. 649, 658, 659, 37 S.W. 497. The mere fact that the tenant might thus have two sources to which he could look for repair or re-

imbursement does not give the plaintiff the right to be subrogated to that right as to one of such sources. Ely v. Ely, 80 Ill. 532; see also Washington etc. Co. v. Weymouth etc. Ins. Co., 135 Mass. 503; Foley v. Manufacturers, etc. Ins. Co., 152 N.Y. 131, 46 N.E. 318, 43 L.R.A. 664; Heller v. Royal Ins. Co., 177 Pa. 262, 35 A. 726, 34 L.R.A. 600; Fire Ass'n v. Patton, 15 N.M. 304, 107 P. 679, 27 L.R.A. (N.S.) 420; Milwaukee etc. Ins. Co. v. Ramsay, 76 Or. 570, 149 P. 542, L.R.A. 1916A, 556; Ann. Cas. 1917B, 1132.

"The English case of Darrell v. Tibbitts, 5 Q.B.D. 560, cited by appellant and hereinabove referred to, if in point, would seem to be contrary to the general weight of authority, and hence is not to be followed on the point in question." (Underscoring added.)

In *Alexandra Restaurant v. New Hampshire Ins. Co.* (1947), 71 N.Y.S. (2d) 515, plaintiff, lessee of a restaurant, was insured by defendant insurance company against loss by fire on improvements of a structural character. The subrogation clause in the policy provided that the insurer could require from the insured an assignment of all right of recovery against any party "to the extent that payment therefor is made by this Company". Without fault of plaintiff or its landlord, a fire occurred causing damage to the improvements. Plaintiff's landlord under the terms of the lease became obligated to repair the damage and did so prior to the time plaintiff's policy became payable. In holding that the plaintiff had suffered a loss and that the insurance company was not entitled

to be subrogated to the rights of the plaintiff against the landlord under the lease, the Court said at page 520:

> "Commenting on the English cases, Richards Law of Insurance, 4th Ed., Sec. 54, pp. 81-83, says: 'If an insurer after loss is a mere surety for some obligor primarily liable, this rule would seem to be indubitably sound, but other courts in this country do not seem disposed to press to such an extreme either the doctrine of indemnity or that of subrogation when applied to the law of insurance. They seem rather inclined to look upon a contract of insurance upon property, if valid and unobjectionable when made, as an absolute promise by the insurer, subject to all the terms of the policy, to pay the damage sustained by the property as measured by its cash or market value (of course, however, not exceeding the amount of insurance), and they declare that inasmuch as premiums are estimated upon that measure of liability any other basis of indemnity is inequitable in principle besides being inconvenient in practice.'
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> * * * * * * *
>
> "* * * The parties agreed that the insurer would make good a 'direct loss and damage by fire' to 'property' to the extent of its 'actual cash value'. The loss occurred and established the rights of the parties. This was the contract between the insured and the insurer. It was not a contract of surety that the landlord would perform his contractual obligation which was wholly independent of any relation to the insurance company.
>
> * * * * * * *

"Plaintiff concededly had an insurable interest when the policy was issued and at the time of the loss. The loss was not caused by any wrongful act of either the landlord or the insured. Defendant's policy insured the property and not the debt due the insured from its landlord. The policy did not contain a clause specifically granting the insurer subrogation to contract rights belonging to insured. In the light of these facts and all the facts stipulated to in this regard it is difficult to see why under the subrogation clause in question, the ultimate loss should fall upon the landlord while the insurance company though accepting and retaining its premium for the precise coverage of loss that occurred, should have no obligation or liability whatever. Cf. Richards, Law of Insurance (4th Ed.), Sec. 54, p. 80." (Underscoring added.)

The instant case is analogous to each of the foregoing two cases in the following respects:

(1) In the instant case, as in each of said cases, the insurer is seeking to be subrogated to the contract rights of the insured under a lease with third parties.

(2) In the instant case, as in each of said cases, the loss insured against was not caused by said third parties.

(3) In the instant case, the obligation of the third parties under a lease is to rebuild the buildings destroyed by fire. In the *Plate Glass* case, supra, the obligation of the third party under a lease was to

"rebuild said building or repair such damage." In the *Alexandra* case, supra, the obligation of the third party under a lease was to repair the damage.

(4) In the instant case, as in each of said cases, the insurer has not insured said contractual obligation of the third parties under a lease, but only the property referred to in the policy of insurance.

(5) In the instant case, as in each of said cases, said obligation of the third parties is independent of that of the insurer to pay the insured the amount it contracted to pay in the policy for the loss sustained.

(6) In the instant case, as in each of said cases, the insurer is primarily liable to the insured for the amount of the loss insured against and said third parties are primarily liable to the insured for the performance of said contractual obligation under said lease.

Since the loss insured against under the policy is not a debt for which the third parties are primarily liable and the insurer secondarily liable, appellant is not entitled to be subrogated to the right of Dunwoody against the lessee appellees under said lease.

A. The United States Circuit Court of Appeals for the Ninth Circuit and the Supreme Court of the State of California have each recognized and applied said doctrine.

The views of this Court on the question as to whether or not an insurer, upon payment of a loss under a policy, becomes subrogated to the rights of

the insured under a contract with a third person are expressed in *American Surety Co. v. Bank of California* (1943, C.C.A. 9), 133 Fed. (2d) 160. In that case, this Court said at page 162:

> "The right of subrogation is a creature of equity, applicable where one person is required to pay a debt for which another is primarily responsible, and which the latter should in equity discharge. In theory one person is substituted to the claim of another, but only when the equities as between the parties preponderate in favor of the plaintiff. That is, a surety's right of recovery from a third party through subrogation does not follow, as of course, upon proof that the losing but recompensed party could have recovered from the third party. Accordingly, subrogation will not operate against an innocent person wronged by a principal's fraud. A surety may pursue the independent right of action of the original creditor against a third person, but it must appear that said third person participated in the wrongful act involved or that he was negligent, for the right to recover from a third person is merely conditional in contrast to the right to recover from the principal which is absolute. The equities of the one asking for subrogation must be superior to those of his adversary. If the equities are equal or if the defendant has the greater equity, subrogation will not be applied to shift the loss.
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> * * * * * * *
>
> "That the law of Oregon is in accord with the principles above set forth is indicated by American Central Ins. Co. v. Weller, 106 Or. 494,

212 P. 803. There, the State Supreme Court held that the insurer's payment of the amount due on a policy, protecting the assignee of a conditional sales contract against loss caused by conversion of an automobile, satisfied the debt in that amount as against defendant, the guarantor of the debt by the assignment of the sales contract to the assignee. The court determined that the rules as to subrogation had no application to the situation in question and narrowly limited that application. Admittedly, the facts vary widely from those in the instant case, but the court's limitation of the subrogation doctrine is significant.

"At first glance, Chicago, St. Louis etc. R. Co. v. Pullman etc. Co. 139 U.S. 79, 11 S. Ct. 490, 35 L. Ed. 97, cited by Insurers, seems contrary to the result reached in the case at bar. There, the insurance company paid the Pullman Company the amount due on a fire insurance policy covering a sleeping car, and subsequently was allowed to recover the said amount by subrogation to the rights of the Pullman Company against the railroad. The railroad was using the car under a contract with the Pullman Company, in which it agreed to pay any damage to the car occasioned by accident or casualty. It was found that under the contract the railroad was primarily liable for the fire damage to the car, whereas the liability of the insurance company was secondary. We agree with the Oregon Supreme Court when it stated in the Weller case that an insurer, having paid a loss, is not entitled to the right of subrogation by virtue of a contract between insured and a third party unless the

contract shows primary liability on the part of such third person for loss of the property insured. In the case at bar there was no express contract on the part of Bank in favor of Interior as there was on the part of the railroad in the Pullman case. Furthermore, there was no primary liability on the part of a third person, the bank, for the loss; the primary liability rested on the employee Crowe. Therefore, the Pullman case is not authority in favor of Insurers herein." (Underscoring added.)

The views of the Supreme Court of the State of California on this question of subrogation to contract rights of the insured are in accord with those of this Court. These views are expressed in *Meyer v. Bank of America etc. Assn.* (1938), 11 Cal. (2d) 92, wherein the Court said at page 102:

"Thus, it may be observed that there are two lines of cases governing the questions here presented, each wholly at variance with the other. We think the great weight of authority rests with the group last referred to, and that the principles there announced, in good conscience ought to be applied to the circumstances of this case. As stated hereinbefore, the right to maintain an action of this kind and to a recovery thereunder involves a consideration of, and must necessarily depend upon the respective equities of the parties. Here, the indemnitor has discharged its primary contract liability. It has paid what it contracted to pay, and has retained to its own use the premiums and benefits of such contract. It now seeks to recover from the bank the amount

thus paid. It must be conceded that the bank is an innocent third party, whose duty to the employer was based upon an entirely different theory of contract, with which the indemnitor was not in privity. Neither the indemnitor nor the bank was the wrongdoer, but by independent contract obligation each was liable to the employer. In equity, it cannot be said that the satisfaction by the bonding company of its primary liability should entitle it to recover against the bank upon a totally different liability. The bank, not being a wrongdoer, but in the ordinary course of banking business, paid money upon these checks, the genuineness of which it had no reason to doubt, and from which it received no benefits. The primary cause of the loss was the forgeries committed by the employee, whose integrity was at least impliedly vouched for by his employer to the bank. We cannot say that as between the bank and the paid indemnitor, the bank should stand the loss. Under the facts of this case, as is stated in Northern Trust Co. v. Consolidated Elevator Co., 142 Minn. 132 (171 N.W. 265, 4 A.L.R. 510): 'The right to recover from a *third person* does not stand on the same footing as the right to recover from the *principal.* (Italics added.)'

"Our conclusion, as hereinbefore has appeared, is that since the bonding company had no superior equities, it was not entitled to be subrogated to any claim plaintiff might have had against the bank." (Underscoring added.)

In light of the fact that the fire which destroyed the insured buildings was not caused by any of the

lessee appellees but was due to causes unknown (R. 41), it cannot be said that there is any superior equity in favor of appellant which would entitle it to be subrogated to the rights of Dunwoody under her lease with lessee appellees.

B. The American cases which have applied the English rule that an insurer, upon payment of a loss, becomes subrogated to all contract rights of the insured are distinguishable from the instant case.

We concede that under the English rule set forth in *Darrell v. Tibbitts* (1878), 5 Q.B.D. 560 (Br. 13), an insurer, upon payment of a loss, is entitled in every instance to be subrogated to all rights of the insured under contracts with third persons respecting the subject matter insured. We recognize that there are American cases, including those cited by appellant (Br. 8-14), which purport to follow the English rule to the point at least of holding that, upon payment of a loss under a policy, an insurer becomes subrogated to the rights of the insured under a contract with a third person when the loss insured against is a debt for which such third person is primarily liable and the insurer is secondarily liable. These cases are distinguishable from the instant case in that in every one of said cases the third party was responsible and agreed to pay for the loss insured against, whereas in the instant case the lessee appellees were not responsible and did not agree to pay for the loss insured against, but merely to rebuild the buildings destroyed by fire. There is no primary liability on the part of lessee appellees to pay for

said loss. As recognized by this Court in the *American Surety Co.* case, supra, this distinction is determinative as to whether an insurer is entitled to be subrogated to the contract rights of the insured under a contract with a third person.

C. The subrogation clause contained in the policy issued by appellant to Dunwoody limited appellant's right of subrogation.

As heretofore set forth, appellant's claim in this action is based upon the principle that an insurer's right of subrogation arises by operation of law and is not dependent upon any express provision therefor in the policy (Br. 14). We have no quarrel with this principle. However, the question of the effect of a subrogation clause such as that contained in the policy issued by appellant to Dunwoody, on an insurer's equitable right of subrogation has not been raised in any of the cases cited by appellant in support of such claim (Br. 14-17).

That the equitable right of subrogation is not absolute, but may be limited by a provision in the policy[1], as was done in the instant case, was recognized by the Court in *Merchants Fire Assur. Corp. v. Hamil-*

[1]That the subrogation clause contained in the California Standard Form Fire Insurance Policy issued by appellant to Dunwoody limited the insurer's equitable right of subrogation was in effect recognized by the Legislature of the State of California when it changed the subrogation clause in the California Standard Form Fire Insurance Policy effective July 1, 1950. Said clause reads: "This company may require from the insured an asignment of all right of recovery against any party for loss to the extent that payment therefor is made by this company." (Section 2071 of the Fire Insurance Code of the State of California.)

ton Co. (1949, R.I.), 69 A. (2d) 551, wherein the subrogation clause construed by the Court was exactly the same as the subrogation clause contained in the policy issued by appellant to Dunwoody. In that case, the complainant issued to the respondent a fire insurance policy which contained a provision that if the complainant shall claim that the fire was caused by the act or neglect of any person or corporation the complainant shall, on payment of the loss, be subrogated to all right of recovery by the insured for the loss resulting therefrom and such right shall be assigned to the complainant by the assured on receiving such payment. Subsequently, the building insured was damaged by fire. The complainant paid the amount of loss to the respondent. Thereafter the complainant discovered that the fire was caused by the negligence of a third person and that the respondent had compromised an action which it had brought against said third person to recover from him the amount of loss or damage to the insured premises caused by the fire. In holding that the complainant was not entitled to be subrogated to the rights of the respondent against said third party in that it failed to comply with the provisions of the subrogation clause contained in the policy, the Court said at page 554:

> "This court has apparently recognized the general principle upon which the complainant chiefly relies which is in substance that an insurer's right of subrogation, a contract of fire insurance being one of indemnity, is not necessarily dependent upon the provisions of the policy alone

but exists as a recognized equitable right in the appropriate circumstances. * * *

"The recognition of the above broad principle of law does not, however, determine the instant cause. The respondent contends that such a right of subrogation as the complainant is here claiming, being personal in nature, may be modified, curtailed or defeated by a provision in the insurance contract entered into by the insured and the insurer. The respondent argues that the pertinent provision in the policy of insurance as set out in the bill of complaint, when properly construed, shows that the parties limited the complainant's right of subrogation by requiring as a condition to the maintaining of such a right that the complainant must, at or before the time of payment of the loss, assert its claim that the fire bringing about such loss was caused by the act or neglect of some third person.

"An examination of the cases called to our attention on the above point, in the judgment of a majority of the court, tends to show that the weight of such authority as there is supports the respondent's position that the provision in the insurance contract we have under consideration should be construed as requiring that the insurer make such a claim as above indicated and make it at or before the time it pays the loss if it desires later to enforce its right of subrogation.

"In Fire Association of Philadelphia v. Schellenger, 84 N.J.Eq. 464, 94 A. 615, 616, where the facts closely resembled those in the present cause and where the complainant was denied relief, a

provision in a fire policy in exactly the same language as the provision now before us was construed as follows: 'The rights of the parties to this litigation, therefore, must depend upon the meaning of the provision of the policy which deals with the matter of subrogation. It is plain from a reading of this part of the contract that the parties to it intended that the right of the insurer, in case it paid the loss, should not be an absolute, but a conditional one; the condition being that the insurer should "claim that the fire was caused by the act or neglect" of some third person.'

* * * * * * *

"Upon consideration it is the opinion of a majority of the court that the provision of the policy before us should be construed in accordance with the holdings in the cases relied on by the respondent, namely, to the effect that it is the intent and meaning of such provision that the right of the insurer to subrogation is not absolute but is on the condition that it make claim, at or before the time it pays the loss, that the fire was caused by the act or neglect of some third person. When issued the policy becomes the contract of the parties. It is reasonable to assume that the provision was inserted in the policy for some purpose. From its terms it does not appear to be a mere confirmatory restatement of the equitable principles governing subrogation generally, nor does it act to enlarge or increase them. On the contrary, when read as a whole its apparent object is to limit and place a condition upon the exercise of such right of subrogation." (Underscoring added.)

In the foregoing case the Court cited the following cases wherein the same construction and result were reached after consideration of the meaning of clauses identical with the one construed by it.

Firemen's Ins. Co. v. Georgia Power Co. (1935), 181 Ga. 621, 183 S.E. 799;

Home Ins. Co. v. Hartshorn (1922), 128 Miss. 282, 91 So. 1;

Fireman's Fund Ins. Co. v. Thomas (1934), 49 Ga. App. 731, 176 S.E. 690.

Appellant seeks to distinguish the *Merchants* case from the instant case in that the *Merchants* case was dealing with the right of subrogation to a tort liability whereas the instant case relates to a contract liability (Br. 16). Appellant ignores the fact that in the *Merchants* case, the Court determined that the equitable right of subrogation of an insurer may be enlarged or limited by a provision inserted in the policy and that when such provision is inserted in the policy then the subrogation rights of the insurer are to be determined solely by said provision. The Court drew no distinction between the equitable right of subrogation arising from contract liability and that arising from tort liability. That no such distinction is to be drawn is apparent from the fact that the subrogation clause construed by the Court in the *Merchants* case commences, as does the subrogation clause contained in the policy issued by appellant to Dunwoody, "If the company shall claim that the fire was caused by the act or neglect of any person * * *" and that the

Court construed said clause as requiring, as a condition to maintaining the right of subrogation, that the insurer must make such claim. In other words, the insurer's right of subrogation is limited to cases comprehended by the provisions of said clause, namely, to tort cases.

Appellant contends that in New Jersey and in Georgia, in which States the Courts have reached the same result as that reached by the Court in the *Merchants* case, the right of an insurer to subrogate against a third party whose liability is founded in contract has been upheld (Br. 17). In support of its contention appellant cites (Br. 17) *Leyden v. Lawrence* (N.J. 1911), 81 A. 121 and *Gainesville etc. Bank v. Martin* (Ga. 1939), 1 S.E. (2d) 636. In neither of these cases was an argument advanced that there was a subrogation clause in the policy which limited the insurer's equitable right of subrogation. It does not appear that the policies contained a subrogation clause the same or similar to that contained in the policy issued by appellant to Dunwoody.

Appellant cites *Field v. Western Etc. Ins. Co.* (N.Y. 1943), 48 N.E. (2d) 489, 146 A.L.R. 434, as a case wherein appellant contends the Court treated a policy of insurance as though it contained no subrogation clause at all because the subrogation clause contained in the policy was not applicable to the situation with which the Court was dealing (Br. 17). In that case, the Court merely held that a clause requiring the insured to assign all right of recovery against any party

for loss or damage did not give the insurer the right of subrogation to contract rights of the insured.

II.

APPELLANT'S ARGUMENT THAT THE LESSEE APPELLEES ARE NOT ENTITLED TO THE BENEFIT OF APPELLANT'S INSURANCE PAYMENT TO APPELLEE DUNWOODY IS IMMATERIAL TO THE ISSUE BEFORE THIS COURT.

Nowhere in the pleadings filed by the lessee appellees does it appear that they have taken the position, as contended by appellant (Br. 20), that the proceeds of appellant's policy inure to their benefit and are to be applied to the cost of restoration of the burned buildings. While it is true, as indicated by the answer of Dunwoody to Interrogatory No. 12 propounded to her by appellant (Br. 20), that appellees Harold F. Baruh and Harold A. Goldman have requested that Dunwoody apply the proceeds of her policy to the rebuilding of the destroyed buildings, no claim has been made by lessee appellees in this action that they are entitled to said proceeds. Whether they are or are not is immaterial to the aforesaid issue before this Court.

III.

SINCE THE TRIAL COURT RENDERED JUDGMENT IN FAVOR OF APPELLEES AND AGAINST APPELLANT, APPELLANT HAS NO RIGHT TO CLAIM IN THIS COURT RELIEF NOT PRAYED FOR IN ITS COMPLAINT.

In support of its contention that the trial Court "should have included in the judgment a declaration that upon full restoration of the buildings appellant would be entitled to a return of the amount so paid, and that in the event of a failure upon the part of lessees to fulfill their obligation to restore the buildings appellant would be entitled to be subrogated to appellee Dunwoody's right to enforce this obligation * * *" appellant cites Rule 54(c) of the Federal Rules of Civil Procedure which reads:

> "Demand for Judgment. A judgment by default shall not be different in kind from or exceed in amount that prayed for in the demand for judgment. Except as to a party against whom a judgment is entered by default, every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings." (Underscoring added.)

Appellant overlooks the fact that the trial Court rendered judgment in favor of the appellees in this action and against appellant. The foregoing rule only applies to judgments entered in favor of a party and therefore does not support appellant's contention.

IV.

CONCLUSION.

It is submitted that the trial Court's finding in favor of the lessee appellees on the issue before this Court is amply supported by the evidence and the law and therefore the judgment of the trial Court should be affirmed.

Dated, San Francisco, California,
October 1, 1951.

Respectfully submitted,
OSCAR SAMUELS AND TEVIS JACOBS,
Attorneys for Appellees Harold A. Goldman, Myrtle Goldman, Harold F. Baruh and Doris G. Baruh.

ROBERT SILLS,
Of Counsel.

No. 12,960

IN THE

United States Court of Appeals

For the Ninth Circuit

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA (a corporation),
Appellant,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, and DORIS G. BARUH,
Appellees.

BRIEF OF APPELLEE MILDRED A. DUNWOODY.

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Attorneys for Appellee Mildred A. Dunwoody.

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No. 12,960

IN THE

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MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, and DORIS G. BARUH,
Appellees.

BRIEF OF APPELLEE MILDRED A. DUNWOODY.

PREFACE.

Appellee, Mildred A. Dunwoody, agrees with appellant's statement of the case, but believes it too limited. Appellee will, therefore, present her statement as briefly as possible, consistent with clarity.

STATEMENT OF CASE.

Appellee Dunwoody was owner of buildings in Chico, California, and leased them to Grand Rapids Furniture Company for fifty years, commencing Jan-

uary 1, 1944, by written lease, dated November 1, 1943 (R. 77). The interest of Grand Rapids Furniture Company was transferred to the appellees, Harold A. Goldman, Myrtle Goldman, Harold F. Baruh, and Doris G. Baruh, and they are still lessees of the premises (R. 77).

Paragraph 12 of the original lease of 1943 reads as follows:

> "Should the whole or any part of any building or buildings at any time standing on the demised premises be partially or totally destroyed by fire after the commencement of the term hereof, the same shall be restored by the Tenant at its own expense without unnecessary delay. The Tenant covenants and agrees that it, the Tenant, shall at all times during the term hereof and at its own expense keep any and all buildings or improvements now upon or hereafter constructed or placed upon said premises, insured against loss or damage by fire in an amount equal to eighty (80) per cent of the full insurable value thereof above the foundation walls. All such policies of insurance shall be payable to the landlords and Tenant as their interest may appear, and shall be written by solvent fire insurance companies authorized to do business in the State of California. Such Policies of insurance shall be held by the Tenant, and the Landlords shall be furnished with the usual certificates from insurance companies showing the existence of such policies. In case of loss, the Tenant is hereby authorized to adjust the loss and execute the proofs thereof in the names of both the Tenant and the Landlords. So long as the Tenant shall comply with the provisions of this lease, respecting fire insurance, the

Landlords covenant and agree not to carry or permit to be carried during the term of any extension of renewal thereof, any additional or other fire insurance covering any interest in the demised premises without the knowledge and consent of the Tenant, but if the Landlords shall desire to carry additional insurance and request the tenant to consent thereto, its consent shall not be unreasonably withheld when any such insurance shall not jeopardize or decrease the amount recoverable under the insurance or self insurance herein provided to be carried by the Tenant. The Tenant shall, upon the request of the Landlords furnish the Landlords evidence of its compliance with these provisions and of the fact of coverage adequate in the premises.

"Notwithstanding anything else herein contained to the contrary, if the premises or a portion thereof be damaged by fire, upon the payment of insurance by the insurance company of the loss to the parties hereto as their interests may appear, all of such payment may be used by the Landlord for the purpose of restoring the portion damaged if the Landlord desires."

For the purpose of facilitating the trial in the action, a stipulation of fact was entered into by the parties (R. 37), and later a supplemental stipulation of fact was entered into (R. 65). Hereafter, when a fact is referred to herein, it will be to a fact "stipulated" in one or the other of the aforementioned stipulations, unless otherwise stated.

Appellee, in accordance with the lease, secured the consent of the other appellees herein, the lessees of the

property, to carry fire insurance upon the demised premises, and secured a policy in appellant company in the amount of $10,000.00 (R. 38).

In pursuance of Paragraph 12 of the original lease (supra), the lessees, the other appellees herein, took out insurance against fire with the Security Insurance Company of New Haven, in the amount of $36,795.00; the insured were the defendants and appellees, Harold F. Baruh and Harold A. Goldman and/or M. Dunwoody; such policy insured the replacement costs of said buildings without deduction, but with depreciation (R. 41). The total insurance carried under both policies was $46,795.00.

The buildings were totally destroyed by fire on April 8, 1949 (R. 41), while both policies were in existence. The policies taken out by the lessee appellees were acknowledged by Security Insurance Company a total loss, and payment thereon was made as follows: $25,000.00 in cash, and $11,743.89 to be paid at a later date, as agreed in the policy (R. 65). The policy of appellant in favor of appellee, in the sum of $10,000.00, was not, and has not been paid (R. 6 and 7).

The $25,000.00 that was paid to the appellees Goldman and Baruh was deposited in their own name. They, at the time, claimed it was their moneys; however, after negotiations, the $25,000.00, less $1,173.89, which was expended to remove debris upon the property, was deposited in the name of the appellee Dunwoody, and in the names of appellees Baruh and Goldman, in a savings account in a bank in San Francisco, to be withdrawn only upon the signatures of Mildred

A. Dunwoody and Harold A. Baruh or Harold F. Goldman (R. 66).

Appellant entered the trial of the action claiming that the buildings were overinsured, and that their replacement value was less than insurance carried, namely, $46,795.00. Later, however, and in open Court, appellant withdrew such claim and orally stipulated that the replacement value of the buildings was in excess of $46,795.00, and in its opening brief states: "It subsequently developed by stipulation, however, that the loss by fire was in excess of the total amount of fire insurance; this eliminates any question of apportionment * * *" (Brief 4).

Following the fire, appellee Dunwoody was faced with the following:

(1) Claim by appellant insurance company that it either owed her nothing, or $7,170.49 (Compl. R. 7). (This claim was abandoned during trial.)

(2) Claim of co-appellees Goldman and Baruh that they were not obligated, under paragraph 12 of the original lease of 1943, to restore the buildings.

(3) Claim of lessee co-appellees that the insurance moneys received by them belonged to them. (This claim was resolved prior to trial by the co-appellees depositing the money in a savings bank in the names of the three appellees as set forth above.)

JUDGMENT.

The judgment (R. 82) is fourfold and as follows:

(1) That the appellee Dunwoody recover from appellant $10,000.00, the full value of the policy, with interest at the rate of 7% per annum from January 21, 1950, until paid, and costs of suit in the sum of $20.00.

(2) That upon the payment of the aforementioned sum to appellee Dunwoody, the appellant is not entitled to be subrogated to any of the rights of said appellee Dunwoody against the lessee appellees.

(3) That appellees Harold A. Goldman and Harold F. Baruh are legally bound to perform the obligations of paragraph 12 and the provisions of that certain lease dated November 1, 1943.

(4) That the lessee appellees recover from appellant $20.00 costs.

APPEAL.

Appellant appeals from the following portions of said foregoing judgment (R. 84):

(1) The judgment in favor of appellee Dunwoody and against appellees.

(2) The judgment that upon payment by appellant to appellee Dunwoody of said sum of $10,000.00, the appellant is not entitled to be subrogated to any of the rights of the said appellee Dunwoody as against co-appellees.

(3) That the co-appellees do have and recover costs in the sum of $20.00.

No appeal was taken by the other parties to the action, and thus this appeal is prosecuted only by appellant, Hardware Mutual Insurance Company of Minnesota, a corporation.

ISSUES ON APPEAL.

While the appellant has appealed threefold, as shown above, it apparently has abandoned its appeal from the money judgment in favor of the appellee Dunwoody, and appears to limit the issue on appeal solely to whether it is or is not entitled to be subrogated *pro tanto* to the rights of appellee Dunwoody against appellees Harold Goldman and Harold Baruh under the lease.

In the matter, we have had the opportunity of reviewing both appellant's brief, and the co-appellees', Goldman and Baruh, brief. The latter brief analyzes cases cited by appellant, and with such analysis and the conclusions drawn therefrom in such brief, we fully concur, and deem it would be a waste of time of the Court for us to further review these cases.

ARGUMENT.

I.

THE JUDGMENT IN FAVOR OF APPELLEE DUNWOODY IN THE SUM OF $10,000.00 PLUS INTEREST AND COSTS, SHOULD BE UPHELD.

The appellant having abandoned its appeal as to the portion of the appeal appealing from the judgment

that appellant pay to the appellee Dunwoody the sum of $10,000.00 plus costs and interest, this judgment should be upheld.

Irrespective of whether or not appellant abandoned this portion of its appeal or not, the Court perforce would have upheld the judgment, inasmuch as the appellant contends that it is entitled to be subrogated to certain rights of the appellee Dunwoody, and the law is that before any rights of subrogation may be invoked by an insurer, it must have paid the insured in full (Ins. C.A. Sec. 2070, 2071).

II.

THE APPELLANT IS NOT ENTITLED TO BE SUBROGATED TO ANY RIGHTS OF THE APPELLEE DUNWOODY.

The sole contention of the appellant on this appeal is that the judgment should provide for subrogation of appellant to certain rights of the appellee Dunwoody. In its brief it phrases its contention as follows:

> "The trial court erred in finding and holding that upon the payment of $10,000 by appellant to appellee Dunwoody pursuant to the judgment of the court, appellant is not entitled to be subrogated pro tanto to the rights of appellee Dunwoody against appellees Harold Goldman and Harold Baruh under the lease whereby the last named appellees are obligated to restore the premises."

Under Paragraph 12 of the original lease of 1943, appellee Dunwoody had two rights against co-appellees in the event of destruction of the buildings by fire, they being:

1. To require co-appellees to restore the buildings, and

2. To take the insurance moneys paid the co-appellees and herself rebuild.

Certainly appellant does not wish to be subrogated to the rights of appellee Dunwoody to take the insurance money and rebuild, nor does it claim such right. Therefore, there remains for the appellant to claim only that it has the right of subrogation to compel co-appellees Baruh and Goldman to restore the buildings.

Plate Glass Underwriters' Mutual Insurance Co. v. Ridgewood Realty Co. (1925), 219 Mo. App. 186, 269 S.W. 659.

In respect to the claim of appellant, we deem the case of *Plate Glass Underwriters' Mutual Insurance Company v. Ridgewood Realty Company* (1925), 219 Mo. App. 186, 269 S.W. 659, while a decision of a foreign Court, determines the issue in this case. This case is fully analyzed in the brief of the co-appellees on page 9, and it would only be repetition to again analyze it here, but we urge the principles it enunciates.

Meyer v. Bank of America (1938), 11 Cal. (2d) 92;

American Alliance Insurance Company v. Capital National Bank of Sacramento, 75 Cal. (2d) 787.

Also, we urge the principles enunciated in the actions of the above-cited cases; those principles are fully considered in co-appellees' brief, with their analysis.

However, there are other considerations which should prompt the Court to uphold the judgment attacked.

In this action there has been no proof that the buildings may be restored; there is no proof of the cost of restoration, if they could be restored. The record does show that the replacement cost of the buildings that existed exceeds $46,795.00, but by how much?

Also, suppose the appellee Dunwoody becomes disgusted with the situation, which well she might. The fire occurred upon April 8, 1949, and after two years and one-half she has not yet received her insurance money, although she carried the insurance for eighteen years, nor have her buildings been restored, and finds herself in Court at no inconsiderable expense. If appellee Dunwoody elects to take the insurance money, cancel the co-appellees' contract or lease, and rebuild her own buildings, would the appellant's contention be that she is unable to do so because it jeopardizes their alleged rights of subrogation? These possibilities are only mentioned to show the absurdness of appellant's position; can an insurance company, by claiming the right of subrogation, destroy the substantial rights of the lessor under her contract or lease, which would be the case if she were denied her right to take the insurance money and herself rebuild. We submit that it cannot.

However, other considerations should require the Court to uphold the judgment.

The provisions of the policy of insurance should control; the policy provides (R. 44):

> "SUBROGATION. If this company shall claim that the fire was caused by the act or neglect of any person or corporation, this company shall, on payment of the loss be subrogated to the extent of such payment to all right of recovery by the insured for the loss resulting therefrom, and such right shall be assigned to this company by the insured on receiving such payment."

This provision limits the right of subrogation of insurer to where it claims that the loss was occasioned by the "act or neglect of any person or corporation". Here appellant does not claim the fire loss was occasioned by the act or negligence of anyone. In construing a similar policy, the Courts of other jurisdictions have upheld this limitation upon the right of subrogation when such limitation is part of the policy.

Merchants Fire Assur. Corp. v. Hamilton Co. (1949, R.I.), 69 A. (2d) 551.

In its construing of the meaning of a similar provision in an insurance policy, the Supreme Court of New Jersey in

Fire Association of Philadelphia v. Schellenger, 84 N.J. Eq. 464, 94 A. 615, 616,

said:

> "The rights of the parties to this litigation, therefore, must depend upon the meaning of the provision of the policy which deals with the mat-

> ter of subrogation. It is plain from a reading of this part of the contract that the parties to it intended that the right of the insurer, in case it paid the loss, should not be an absolute, but a conditional one; the condition being that the insurer should 'claim that the fire was caused by the act or neglect' of some third person."

In its brief, appellant claims the right that in the event the buildings are restored by the co-appellees, to proceed against appellee Dunwoody to recover the amount of insurance paid by it to her, or, if the buildings be not restored, the right to proceed against the co-appellees, Goldman and Baruh, to collect such moneys. Nowhere heretofore has the appellant presented this position; it arises for the first time upon this appeal. We refer the Court to the prayer of the appellant's complaint (R. 7).

In its prayer appellant succinctly states its position. Nowhere therein is asked a recovery from the appellee Dunwoody if the buildings be rebuilt, nor from the co-appellees if they be not rebuilt. These questions are beyond the issues, as pointed out in co-appellees' brief on pages 26 and 27.

CONCLUSION.

I. Appellee Dunwoody respectfully submits that the judgment in her favor should be sustained, and that she be allowed her costs upon this appeal.

II. Appellant Dunwoody also respectfully submits the entire judgment appealed from be sustained.

Dated, Chico, California,
October 19, 1951.

Respectfully submitted,
PETERS AND PETERS,
Attorneys for Appellee
Mildred A. Dunwoody.

No. 12,960

IN THE

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For the Ninth Circuit

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a corporation,

Appellant,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, and DORIS G. BARUH,

Appellees.

APPELLANT'S REPLY BRIEF.

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Appellees.

APPELLANT'S REPLY BRIEF.

STATEMENT OF THE CASE.

Lessee appellees charge (2-5) that appellant "has omitted" from its statement of the case "essential" facts. That this charge is unfounded is readily demonstrated by a brief notice of the supposed omissions, claimed to be four in number.

(1) The terms of the subrogation clause in appellant's policy. This clause will be found quoted in full in our brief (15).

(2) The fire was due to causes unknown. This fact is and always has been undisputed, and is implicit in our entire discussion of the case.

(3) The terms of paragraph 12 of the lease. This paragraph is fully discussed in our brief (2-3; 18). The essentiality of the last sentence of paragraph 12 as quoted by lessee appellees (3) nowhere appears, since appellees do not refer to it elsewhere.

(4) The policy issued by Security Insurance Company. This policy is referred to in our statement of the case (4). The "essential" facts concerning it are contained in lessee appellees' statement of the case (3-4); but lessee appellees do not trouble to point out in argument why or in what manner these facts are "essential" or even relevant.

REPLY TO ARGUMENT OF LESSEE APPELLEES.[1]

I. SUBROGATION OF INSURER TO CONTRACT RIGHTS OF ITS INSURED.

Lessee appellees concede (19) that the English rule grants subrogation to an insurer to those rights of its insured which arise from contract as well as to those which arise from tort liability; and further concede (19) "that there are American cases, including those cited by appellant[2] which purport to follow the English rule * * *"

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[1]Designation of subdivisions (I, II, and III) under this point follow the designations found in the brief of lessee appellees.

[2]These authorities will be found on pp. 8-14 of our brief. They include textual statements from the article on insurance law in *Corpus Juris Secundum*, and from the insurance treatises of *Apple-*

These authorities lessee appellees brush cavalierly aside by saying (19):

> "These cases are distinguishable from the instant case in that in every one of said cases the third party was responsible and agreed to pay for the loss insured against, whereas in the instant case the lessee appellees were not responsible and did not agree to pay for the loss insured against, but merely to rebuild the buildings destroyed by fire."

So far as this "distinction" is concerned, we submit that it is a distinction without a difference—a distinction in phraseology without underlying substance.

It is, of course, true that in every case ever decided where subrogation was successfully pursued by an insurer against a third party, the third party "was responsible * * * for the loss insured against"; this is obviously a *sine qua non* of subrogation. We categorically deny, however, that the cases cited are cases where the third party agreed "to pay for the loss insured against" rather than to "rebuild" (or repair) the property damaged by fire.[3] For example, in *Chicago etc R Co v Pullman etc Co* (1890) 139 US 79, 11 SCt 490, 35 LEd 97,[4] the agreement by the third party (lessee of railroad cars) was that it should—

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man, Couch, and *Joyce.* They also include case law from decisions of the United States Supreme Court and other federal courts, and from the states of California, Connecticut, New York, Oregon, and West Virginia.

[3]Note that lessee appellees say (19) that this is true of "every one" of the cases cited by us.

[4]Appellant's Brief, p. 11.

> "repair all damages to said cars of every kind occasioned by accident or casualty during the continuance of this contract * * *" (139 US 82, 35 LEd 99.)

This was the agreement or obligation to which the Supreme Court decreed the insurer was entitled to be subrogated.

Lessee appellees (15-15) cite, quote at length from, and rely upon *American Surety Co v Bank of California* (CCA 9, 1943) 133 F2 160, as establishing the rule in this circuit, contrary to the authorities cited by us, that an insurer will not be subrogated to the rights of an insured arising under a contract with a third person. The *American Surety* case, however, is not only not authority for the proposition to which it is cited by lessee appellees, but is rather persuasive authority in support of appellant's position. In that case this Court took pains to point out that its decision denying subrogation under the facts involved[5] was not inconsistent with or contrary to the decision in *Chicago etc R Co v Pullman etc Co* (1890) 139 US 79, 11 SCt 490, 35 LEd 97, which is one of the line of authorities upon which appellant relies. After stating the facts in the *Pullman* case, this Court said (133 F2 164):

> "In the case at bar there was no express contract on the part of Bank in favor of Interior

[5]These facts were in no way analogous to a fire loss subrogation situation. They concerned the attempted subrogation of an insurer covering a depositor against loss caused through dishonesty of its employee against a bank which cashed fraudulent checks drawn by the employee on the depositor's account.

(the depositor) as there was on the part of the railroad in the Pullman case * * * Therefore, the Pullman case is not authority in favor of Insurers herein."

It is of interest to note that the *American Surety* case arose in Oregon. An interesting discussion of the views of the Supreme Court of Oregon on the right of an insurer to be subrogated to contract rights of an insured is found in *National Fire Ins Co v Mogan* (Or 1949) 206 P2 963, 968-9. The court pointed out that the subrogation doctrine as stated by the English courts in the cases of *Darrell v Tibbitts* and *Castellan v Preston*[6] has been followed by many American courts; and that *Plate Glass Underwriters Mutual Ins Co v Ridgewood Realty Co* (Mo 1925) 269 SW 659,[7] "represents a contrary view".

Lessee appellees state (17) that the views of the California Supreme Court on the question of subrogation to contract rights "are in accord" with those of the Court of Appeals of this Circuit.[8] They cite *Meyer v Bank of America etc Assn* (1938) 11 C2 92, 77 P2 1084. The *Meyer* case is admittedly on all fours factually and legally with the *American Surety* case, and for the reasons noted above is not therefore helpful to appellees.

We shall next comment upon the only two cases cited by lessee appellees which to any degree at all support their position with respect to subrogation.

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[6]Appellant's Brief, pp. 12-13.
[7]This case is cited by lessee appellees, and is discussed below.
[8]We do not disagree with this statement.

(1) *Plate Glass Underwriters Mutual Ins Co v Ridgewood Realty Co* (Mo 1925) 269 SW 659, is discussed by lessee appellees at length (9-11). We concede that there is language in this case which, as pointed out in the Oregon case of *National Fire Ins Co v Mogan* (supra), "represents a contrary view" to that expressed by the English cases and the considerable weight of American authority. Nevertheless, this language (as lessee appellees neglect to point out) is dictum, because the court had already determined that the third party landlord was not obligated under the terms of the lease to make the repairs for which the insurer had paid; and it had also determined that even if he had been so obligated he would have been entitled to notice of the damage and a reasonable opportunity to make the repairs himself—neither of which conditions were met. These determinations were, of course, fatal to any right of subrogation because they were fatal to any right of recovery on the part of the insured to which the insurer could be subrogated.

There can be no dispute but that the dictum in the *Plate Glass* case represents a minority view. In addition to the authorities cited in our brief, we call attention to the cases of *Container Co v United States* (Ct Claims, 1950) 90 FS 689, 694:

> "The insurers, by paying for the damage, became subrogated to the insured's contract claim against the United States."[9]

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[9]Footnote 11 appended by the court to the foregoing holding refers to the English and American authorities, and observes:

> "Some American courts have not allowed subrogation to contract claims * * * But the general rule is that an insurer is

and *Borserine v Maryland Casualty Co* (CCA 8, 1940) 112 F2 409, 414, footnote 2. One of the cases cited in this footnote is *Iowa State Ins Co v Missouri etc R Co* (Mo 1928) 9 SW2 255, 256. This case would appear to cast some doubt upon the validity of the *Plate Glass* dictum as authority even in Missouri, because although the case itself involved subrogation against a tort-feasor it cites as among "the leading authorities" on subrogation the case of *Potomac Ins Co v Nickson* (Utah 1924) 231 P 445, 42 ALR 128. In the *Nickson* case subrogation was upheld in favor of an insurer against a third party liable to the insured under a contract of bailment. The automobile had been garaged with defendant and a claim check issued. Defendant misdelivered the car, but claimed there was no negligence on his part. The trial court held that the defendant was liable to the insurance company by way of subrogation under the contract of bailment, and refused to submit the question of negligence to the jury. This was affirmed on appeal. The court said that the contract of bailment was breached by failure to redeliver the car, and that good faith or negligence of the defendant was immaterial; the insurer was held entitled to be subrogated to the contract rights of its assured.

(2) *Alexandra Restaurant v New Hampshire Ins Co* (1947) 71 NYS2 515 is the other case cited by lessee appellees (11-13) which tends to support appellees' position. It should be noted, however (since lessee appellees do not disclose the fact),

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subrogated to the insured's right of indemnity from a third party in contract as well as in tort * * *"

that the court expressly refused to pass upon the question of what subrogation rights the insurer might have asserted under the policy if the case had involved the question of subrogation. The court said that inasmuch as there had been neither payment of the loss nor recognition by the insurer of any liability to pay anything under the policy, it was unnecessary to determine the scope of the subrogation clause contained in the policy. In the *Alexandra* case the lessor had completely repaired the building prior to the suit by the lessee against its insurer. The insurer contended that judgment should be in its favor in order to avoid double indemnity and an apparent profit to the insurer lessee.

The court recognized that such would be the result under the English doctrine of subrogation, but held otherwise upon the strength of "the weight of controlling authority in this state"—that is, in New York. No attempt was made by the court to ascertain or discuss the general weight of American authority. Apart from the leading English cases, the opinion does not refer to any cases from other than New York courts, although, as our opening brief sufficiently shows (8-14), many such decisions exist, and it has but recently been authoritatively stated that the general rule is contrary to the conclusion reached by the New York court (46 CJS 154-5; Insurance, s 1209, n 17-20).

Moreover, the *Alexandra* case recognizes that the New York authorities cited in the opinion are not entirely harmonious. The court might have gone farther

along these lines and pointed out that in at least two other decisions not referred to in the opinion, the New York courts have subrogated an insurer to contract rights of the insured. In *Interstate Ice etc Corp v US Fire Ins Co* (NY 1926) 152 NE 476, a fire insurer was required to pay the conditional vendor (its insured) the balance due under the conditional sale contract after a partial destruction of the property by fire; the court pointed out that upon such payment the insurer would "succeed by subrogation to the remedies available against the conditional vendee". In *Agricultural Ins Co v Rothblum* (1933) 265 NYS 7, property was lost while in the possession of a bailee. The insurance company paid the value of the property to the insured owner and in this action against the bailee was held entitled to be subrogated to all the rights of its insured under the contract of bailment. The court in the *Alexandra* case might also have noted that in New York it is well settled that under a single interest policy issued to a mortgagee, the insurer upon payment of a loss is entitled to be subrogated to the contract (mortgage) rights of the mortgagee against the mortgagor. *Excelsior Fire Ins Co v Royal Ins Co* (1873) 55 NY 343, 14 AmRep 271, as quoted with approval in *Fields v Western etc Ins Co* (NY 1943) 48 NE2 489, 146 ALR 434, 438.[10]

We submit that, in addition to being at variance with the controlling weight of English and American

[10]The *Fields* case is cited upon this point in our opening brief (9-10).

authority, the *Alexandra* case is wrong in principle because it violates the fundamental doctrine that a contract of property insurance is a contract of indemnity.

> "The doctrine of subrogation was adopted by equity to put the burden of loss on the one primarily responsible for it. This right of subrogation arises out of the nature of the contract of insurance as a contract of indemnity, the carrier being primarily and the insurer secondarily liable. The insurer's right of subrogation exists as a matter of equity, and is not dependent upon the reservation of the right in the contract of insurance." *National Garment Co v N Y etc R Co* (CA 8, 1949) 173 F2 32, 37.

Finally, it is significant that many if not most of the cases dealing with problems of subrogation cite both tort and contract subrogation cases indiscriminately as authority for allowing subrogation in either type of case. See, for example, *Grace v United States* (DC Md, 1948) 76 FS 174, 176, a tort subrogation case which relies upon a number of Supreme Court cases dealing with subrogation to contract and statutory rights of the insured.

II. DO LESSEE APPELLEES CLAIM TO BE ENTITLED TO THE BENEFIT OF THE PROCEEDS OF APPELLANT'S POLICY?

Lessee appellees object (26) to the statement in our brief (20) that they claim that the proceeds of appellant's policy inure to their benefit.

We suggest that this objection is made by lessee appellees with reservations. They are very careful to say (26) that they have made no claim to the proceeds *"in the pleadings"* or *"in this action"*. And, although they assert (6) that they "do not question their obligation to rebuild", they are careful to insist (6) that this obligation runs only to appellee Dunwoody and that appellant must not "be given the right to interfere in the performance, *or non-performance,* or any *negotiations* in relation to, or any *adjustment* of, said obligation".

On the other hand, if lessee appellees do in all good faith concede their obligation to rebuild and their lack of beneficial interest in the proceeds of appellant's policy, we submit that they have no standing to resist appellant's position upon this appeal as the issue of appellant's right to be subrogated to appellee Dunwoody's rights against appellee lessees would appear to be moot as to them.

III. FRCP, RULE 54(c).

Lessee appellees controvert (27) the application of Rule 54(c) FRCP to the prayer of appellant's complaint[11] on the ground that the rule applies only when the party invoking it has been successful in the trial court. They cite no case in support of this position.

The authorities are to the contrary.

Schoonover v Schoonover (CA 10, 1949) 172 F2 526;

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[11]See, Appellant's Opening Brief, p. 8, n. 1.

Roth v Fabrikant Bros (CA 2, 1949) 175 F2 665;

Broidy v State etc Assur Co (CA 2, 1950) 186 F2 490.

REPLY TO ARGUMENT OF APPELLEE DUNWOODY.

In the main, the brief of appellee Dunwoody adopts the arguments made by lessee appellees in their brief. However, a few "other considerations" are mentioned in the Dunwoody brief (10). Only the following points, advanced as they are without argument, require comment.

It is said that "there has been no proof that the buildings may be restored". This is true, but the rights which appellant seeks to have declared will not prejudice appellee Dunwoody in either case. If the buildings are restored by lessee appellees, appellee Dunwoody will not require the proceeds of appellant's policy to be made whole—indeed, she will have been made more than whole without these proceeds for she will have gotten new buildings for old. If the buildings are not restored, appellant will be subrogated *pro tanto* to her rights under the lease, subject in all events to her prior right to have full indemnification for her loss.

It is also said that "there is no proof of the cost of restoration". This is true, but is immaterial to the issues involved in this action.

It is said further that appellee Dunwoody may elect to take the insurance money, cancel lessee appellees' lease, and rebuild the buildings herself; and

it is implied that appellant's position is "absurd" because it might prevent this course of action. There would be nothing in the judgment sought by appellant that would prevent appellee Dunwoody from taking the proceeds of appellant's policy and using them to rebuild. It is true, however, that she would not be in a position to destroy the obligation of lessee appellees to rebuild; this is a necessary and inevitable concomitant of appellant's right of subrogation.

Dated, San Francisco, California,
31 October 1951.

Respectfully submitted,
BERT W. LEVIT,
DAVID C. BOGERT,
LONG & LEVIT,
Attorneys for Appellant.

T. S. Chapman.

No. 671.

IN THE

Circuit Court

OF THE

UNITED STATES

Ninth Circuit

SOUTHERN DISTRICT OF CALIFORNIA

Charles D. Lanning, Receiver, &c.,
Complainant,

vs.

H. C. Osborn et al.,
Defendants.

Complainant's Brief in Support of Exceptions to the Answer.

WORKS & WORKS,
Solicitors for Complainant.

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Complainant's Brief in Support of Exceptions to the Answer.

The questions arising upon the exceptions to the defendant's answer were orally argued. At the close of the argument it was suggested by the court that the solicitors for the respective parties file a statement of their points and authorities.

It was not supposed by us that it was intended that the case should be again argued in full, and, acting upon the request of the court, we filed a brief statement of the main points upon which we relied, with a citation of the authorities, and without any extended argument of any of the points made. But the learned solicitors for the defendants have evidently taken a different view of what was desired by the Court, and have filed extended briefs, one, alone, of which covers sixty pages of printed matter We find it necessary, therefore, considering the importance of the matters involved, and the full and able written presentation of their side of the case by the solicitors for the defendants, to re-discuss the questions that were orally argued. And, in order that our entire argument may be put in printed form, for the convenience of the Court, we first set out in this brief the points and authorities filed by us in the opening. They are as follows:

"Complainant's Points and Authorities in Support of Exceptions to the Answer.

I.

The remedy of the defendants, if the rates established by the company are unreasonably high, is by petition to the board of supervisors, as provided by statute for the establishment of such rates by the board. This is an adequate and speedy remedy, provided by law, and must be resorted to before seeking relief from a Court of Equity, or by separate actions on the part of

individual consumers to compel the company to supply the water.

Const. Cal., Art XIV, Secs. 1 and 2;
Stat. 1885, p. 95, Secs. 1, 2, 5, 6, 10.

II.

The only contracts, alleged in the answer, between the company and consumers, specifically provide that such consumers shall pay the annual rates "*allowed by law and charged by the party of the first part*" or "*at rates fixed by the party of the first part as allowed by law*" or, to "*pay the party of the first part the current rate therefor established for Chula Vista,*" or to "*pay for the use of the water at the current rates as may be enforced from time to time for supplying water.*"

Answer p. 15, line 27; p. 18, line 7; p. 19, lines 8 and 16.

No other contract is alleged in the answer and these clearly contemplate the fixing of rates by the company; but all such contracts are subject to the establishment of rates as provided by statue. In those cases they do not attempt to, nor could they, fix an unalterable rate, but simply bind the parties to pay the rates fixed by the company as provided by law.

III.

But no such contract was necessary. The statute provides, distinctly in what manner rates may be established, viz. 1, by the board of supervisors; 2, by the company itself. But the rate established and collected by the company can only stand until rates are fixed by the supervisors, which can only be done at

the instance of the consumers and cannot be done at the instance of the company. The only protection of the company is its right to fix its own rates. The protection of the consumer lies in his right to have the rates fixed by the company set aside by the supervisors, and other rates substituted.

Statute 1885, p. 96, Sec. 5.

And rates established by the supervisors *may* be changed, each year, on the petition of either the consumers or the company, and when rates established by the supervisors are abrogated without the substitution of others the right to fix the rates again revives in the company.

Stat. 1885, pp. 96, 97, Secs 5, 6.

IV.

The rates fixed by the company are changeable by it the same as by the board of supervisors. This is not expressly provided for by the statute but the whole tenor of the statute indicates it and the necessity of changing the rates, to meet new conditions and circumstances, is necessary for the protection of both the company and its consumers.

V.

The statute declares what shall be reasonable rates, if fixed by the supervisors, viz : such rates as will return to the company not less than six, nor more than eighteen per cent., net, on the value (or cost) of the plant.

VI.

If this court has jurisdiction to, or will, where an

express statutory provision, giving a speedy and adequate remedy at law exists, inquire into the reasonableness of rates fixed by the company, then the court must be bound by the legislative declaration as to what shall be a reasonable rate, and unless it is shown that the rate of $7.00 per acre, per annum, will return more than six per cent., net, on the value (or cost) of the plant, the statutory provision is conclusive that the rate is reasonable, and if it will not exceed eighteen per cent, net, it must be regarded as *prima facie* reasonable. But as to the latter it is unimportant as it will not be contended that the rate will realize to the company the minimum sum, or one-half, or one-third of it.

VII.

Assuming that this court has jurisdiction to, and will, inquire into the reasonableness of the rates, it cannot fix or establish rates. Its jurisdiction extends no farther than to determine whether the rates fixed by the company are, or are not, reasonable.

Regan *v.* Farmers Loan & Trust Co., 154 U. S. 420; 14 Sup. Ct. Rep. 1047, 1054;

Chicago & G. T. R'y Co. *v.* Wellman, 143 U. S. 339, 344; 12 Sup. Ct. Rep. 400, 402.

VIII.

The company is not estoped to change the rate by reason of the fact that it has established and collected a lower rate nor by representations made that such low rate would be maintained, nor can the consumers have any prescriptive right to an unreasonably low

rate. This results, necessarily, from the law declaring that the use of the water is a public use, "subject to the control of the state *in the manner prescribed by law*;" (Const. Cal. Art. XIV, Sec. 1), because the right to collect rates "*cannot be exercised except by authority of and in the manner prescribed by law*;" (Const. Cal., Art. XIV, Sec 2) and because the manner in which the right shall be exercised and the rates fixed *has* been "prescribed by law."

Stat. 1885, p. 95.

And if it is once admitted by the courts that the subject of annual rates can be controlled by representations made by the company selling and distributing the water, or by the consumer, or even by positive contracts between them, the very purpose of the adoption of the constitution, and the enactment of the statute, will be wholly defeated. It was the undoubted purpose and object of both to deprive corporations dealing in water of the power to fix its rates by contract. This time the representations sought to be used as fixing the rates for all time may afford a better protection to the consumer than the constitution and statute. But next time the contract, or representations constituting an estoppel, may be more favorable to the *corporation* than the *law* would be, and then what? The power to fix rates by contract or representations, once admitted, the right must necessarily exist in all cases, and the obligation thereof must be mutual. If instead of the facts alledged in this answer, that the consumer bought his land at a *high* price in consideration that water therefor would

be furnished at a low rate, it should be shown in this or some other case, that he had bought his land at a *low* price in consideration that he would pay a *high* rate for his water, what then? If one would be legal and binding the other would. And if either can be held legal and binding our constitution, so far as it relates to this subject, counts for nothing. And if neither of the parties can be bound to a rate by positive contract, certainly neither could be legally bound, indirectly by representations, or estoppel. Both parties must know the law, and the law is that the rates can only be fixed as prescribed by law, that the manner has been prescribed, and that the prescribed manner is not by contract or estoppel.

As to the effect of a rate having been established and collected by the company, it has been considered above. The same reasons which prevent the fixing of a perpetual rate by contract must prevent the establishment of such rate by mere lapse of time, or prescription.

IX.

The denials are insufficient to meet the allegations of the bill. They go no farther than a denial in part of the amount expended in the construction of the plant beyond the sum of $750,000; deny that in order to pay six per cent. interest on the value of the plant and operating expenses, it is necessary to raise more than $73,000 by the rates; deny that the amount of revenue that can be realized from the present rates is less than $27,000; and deny that a rate of $7.00 per annum per acre is a reasonable rate, *not absolutely*, but because:

1. Each of the defendants is the owner of a perpetual right to the water, and therefore the company is not entitled to any interest on its investment as to them; 2. The rate of $3.50 per acre has been actually established and collected. They deny that any increase of rate is necessary, *not to pay the company any compensation for services in supplying the water or as interest on its plant, but to operate and maintain the plant.* "These denials are unquestionably evasive and do not meet the issues presented by the bill. To hold them sufficient the court must hold that it is only necessary that the rates shall return to the company the bare amount it is compelled to expend in operating and maintaining its plant, and that it must furnish the plant, be responsible for its management, and run all risks incident to such management, for nothing. We expressed our views on this subject at the oral argument and will not weary the court with a mere repetition of what was then said.

X.

The fact that the company constructed the plant in part for the benefit of its own lands, and to enable it to sell such lands, or that its own lands have been enhanced in value thereby, or that it has realized a profit on such lands because of the water having been brought upon them, by the expenditure of its own money, cannot affect its right to annual rates or the amount of such rates. If the board of supervisors were called upon to fix the rates, could it go into an accounting of the company's affairs in its land department to see what it had actually realized on its lands

in order to arrive at just rates? If so no doubt such an investigation would prove that the company has lost money, has become insolvent, and, because of its insolvency, is now in the hands of a receiver. But neither this court nor the board of supervisors could allow it greater rates because of its failure to sell its lands, as expected, in order to make good its losses, nor could they reduce its annual rates becaase it had made a profit on its lands. The whole matter of the company's profits, or losses, on its real estate, is a false quantity in the fixing of rates. It has nothing to do with the cost of the plant, its value, its operating expenses and maintenance, or the value of the services rendered in furnishing the water to consumers, and these are the things made material by statute in fixing the rates "as prescribed by law."

We have given our views, fully, on this subject, in the printed brief filed in the case of San Diego Land & Town Co. *v.* National City, just decided by this court, of which brief the solicitors for the defendants have copies. We respectfully ask to be allowed to refer to what is said in that brief, pp. 6-10, and make the same a part of these points. Also to pp. 9-12 of the reply brief in the same case. The question whether the matters here refered to were proper to be considered in fixing rates was directly presented and fully argued on both sides in that case, but was not decided.

XI.

What should be considered in arriving at just and reasonable rates?

We maintain that the following things should be taken into account:

a. The cost of the plant.

b. The cost per annum of operating the plant, including interest paid upon money borrowed, and reasonably necessary to be used in constructing the same.

c. The annual depreciation of the plant, from natural causes resulting from its use.

d. A fair profit to the company over and above these charges, for its services in supplying the water to consumers, either by way of interest on the money it has expended for the public use, or upon some other fair and equitable basis.

Ames *v.* Union Pac. R'y Co., 64 Fed. Rep. 165, 177;

Chicago & N. W. R'y Co., *v.* Dey, 35 Fed. Rep. 866, 879;

Stat. 1885, p. 196, Secs. 4, 5;

Stat. 1881, p. 55, Sec, 3;

San Diego Land & Town Co. *v.* National City, decided by this court May 4th, 1896.

The last case cited agrees with us as to these different elements being the proper basis for the fixing of rates, except that it holds that the *present value* should be taken instead of the *cost*. It is immaterial in this case whether the present value or the cost is taken, but we respectfully submit that the taking of the present value is both impracticable and unjust. In the opinion it is said: "In the solution of that problem many considerations may enter; among them

the amount of money actually invested; but that is by no means of itself controlling, even where the property was, at the time, fairly worth what it cost. If it has since enhanced in value, those who invested their money in it, like others who invest their money in any other kind of property, are justly entitled to the benefit of the increased value. If on the other hand the property has decreased in value, it is but right that those who invested their money in it, and took the chances of an increase in value, should bear the burden of the decrease. In my judgment it is the actual value of the property at the time the rates are to be fixed that should form the basis upon which to compute just rates, having, at the same time, due regard to the rights of the public, and to the cost of maintenance of the plant and its depreciation by reason of wear and tear. If one has property to sell, it is its present value that is looked to, one element of which may very properly be its cost; but one element only. So, too, if one has property to lease, it is its present value, rather than its cost, upon which the amount of rent is based. And, if, as said by Mr. Justice ~~Bower~~ Lurton in Ames *v.* Northern Pacific Railway Company, *supra*, the public were seeking to condemn the property in question for a greater public use, if that be possible, its present value, and not its cost, is that which the public would have to pay. It follows, I think, that where the public undertakes to reduce the rates to be charged for the use of such property, it is its present value, and not its cost, that must be taken as a basis upon which to fix reasonable and just rates, having due regard to

the cost of its maintenance, to its depreciation by reason of wear and tear, and also to the rights of the public. If, upon such a basis, a fair interest is allowed, no just cause of complaint can exist."

We submit that this basis is impracticable because there is no means by which it is possible to arrive at the value of the plant. It is not the subject of barter and sale in competition with other property of a like kind. Therefore it has no market value. It is largely underground and its condition cannot be ascertained The revenue that can be realized from it, which alone constitutes its true value, depends upon the rates fixed for water, each year, by some one else, and about which the owner of the property cannot contract, and over which he has no control. The commodity in which he deals is not his own, he is a mere agent of the public in appropriating and delivering it. It is not intended that he shall *speculate* in the property. But to say that the person or corporation who owns the property shall bear the loss, in rates, if the property decreases in value, and is entitled to an increased rate if the property increases in value, is to make the matter of securing water rates one of speculation, merely, and does not make them depend, as we submit it should, on the real services rendered by the company to the public, for whom it acts, in the investment of its money in the appopriation and storage of the water, and its services rendered in distributing it to consumers. And what is to be taken into account in arriving at the *value?* Is the water right of the company, or the water stored by it to be considered? If so, how

can the value of the water rights, or the water, be ascertained, and what is the interest of the company in what the constitution makes a public use? We contend that the only tangible and practicable basis for fixing the rates is the amount the company has actually and reasonably expended for the benefit of the public it serves. This basis puts every company on an equal and fair basis, not depending upon speculation or guess work. There can be no analogy between a company dealing in water, and whose price must be fixed by some one else,and a business man, the value of whose property may depend largely upon his own skill and judgment in the management of it, and who can rent, lease, or sell it, or not, as he pleases and demand such prices for it as he pleases, and who is not, like a water company, compelled to take the price offered him whether fair and reasonable or not. We still entertain the conviction that the money properly and necessarily invested is the true test and the hope that your honor will, upon a more careful and thorough study of the question, so determine. It is a question of vast importance and deserves the most careful consideration.

As to the item of natural depreciation. That such depreciation should be considered is distinctly decided in the opinion referred to. But at the oral argument it was intimated from the bench that this would be made good by the amount allowed for money actually expended for repairs. But to any one who has familiarized himself with the actual workings of a water plant, consisting of pipes underground, this

will appear at once, to be wholly impracticable and unjust either to the company or the consumer, or both. The entire pipe system is going to decay gradually. This depreciation cannot be made good by repairs. The pipe may be patched and banded, when leaks occur, which constitute repairs in the legitimate and proper sense. But, sooner or later, the pipe becomes so decayed that the whole line must be replaced. In the case of the San Diego Water Company of San Diego, which we take as an illustration of our meaning, this has actually occured. On one of its main pipe lines leading into the city, leaks have been occuring from time to time and the company has been placing bands on the pipe and resorting to other means to stop the leaks. But the pipe has become so decayed and full of "pin holes" that "repairs" will no longer answer the purpose, but the entire pipe line must soon be replaced by a new one. This will cost probably $40,000. If this large expenditure must be made would it be just to charge it up against the consumers as repairs for this year? If so the operating expenses would be just about doubled If charged as repairs of course the whole of it must be paid by the consumers. If it is new construction, and the company has not, in all these years, been allowed anything for the depreciation that has gone on, and which has finally compelled it to make this large expenditure, it is just $40,000 the looser. The percentage of depreciation is no longer a matter of speculation or guess work. It has been demonstrated by actual experience to a reasonable degree of certainty. It is far easier to

determine with justice to the company and the consumers than the present value of the plant. If it is once declared that such replacements of pipes are legitimate repairs then consumers must suffer the consequences, and, as these underground distributing systems grow older, the burden imposed for such repairs will be unbearable. The only just and fair method of meeting this loss is to add to the rates of each year a proper amount to meet this depreciation and leave it to the company to make the additions, when necessary, *as construction*, and not as *repairs*.

XIV.

The amount in controversy, as between the complainant and one defendant, is not the test of jurisdiction in this court. A suit against all of the consumers is the proper one to bring. The question cannot properly be litigated between the receiver and each consumer separately.

Chicago M. & St. P. R'y Co. *v.* Minn. 134 U. S. 118; 10 Sup. Ct. Rep. 702, 703.

In the case cited Mr. Justice Miller, in his concurring opinion, states the rule as follows:

"6. That the proper, if not the only, mode of judical relief against the tariff of rates established by the legislature, or by its commission, is by a bill in chancery asserting its unreasonable character, and its conflict with the constitution of the United States, and asking a decree of court forbidding the corporation from exacting such fare as excessive, or establishing its right to collect the rates as being within the limits of a just compensation for the service rendered.

"7. That until this is done it is not competent for each individual having dealings with the carrying corporation or for the corporation with regard to each individual who demands its services, to raise a contest in the courts over the questions which ought to be settled in this general and conclusive method."

With respect to the question whether we have, by our bill, shown sufficiently that we are entitled to sue in this court, on the ground of the danger of the multiplicity of suits, we deem it better to wait until we hear what is said by the other side before taking it up. But we do not wish to be understood as admitting that the threatened multiplicity of actions is the only reason for coming into this court. On the contrary if no such suits were threatened, either the company or the receiver could bring all the defendants before the court, in one suit, to settle the question of its right to establish and collect the rate now in controversy."

I

Novelty of the Position Taken by the Defendants.

The learned solicitors for the defendants are somewhat at variance as to the grounds upon which they should attempt to defeat the complainant's right to collect the new rate the company has established. Hence the necessity of three separate briefs, one by each solicitor, separately, instead of one joint brief. But upon some things they do agree, viz: that in their judgment the San Diego Land and Town Company is not

a *public* corporation but a *private* one; that the waters of the Sweetwater river, appropriated by the company, are not held by it as a *public use*, but are its own private property; that the sale and distribution of the water is not subject to the provisions of the constitution and statute making the use of all water appropriated for sale, rental or distribution a public use, and subject to the regulation and control of the state, and prescribing how the rates therefor shall be fixed, but that the sale of such water is the subject of private contract wholly free from said constitutional and statutory provisions. This is a most singular position for water consumers to take. The laws from which they are struggling to escape were enacted solely for their benefit and protection, and to limit the powers and rights of corporations to take up the waters of flowing streams, and make such waters their own private property. But the exigencies of their case have driven them to this hitherto unheard of position. And what a selfish and untenable position it is! Here are a mere handful of consumers attempting to establish a doctrine, not only subversive of the constitution and laws of the state, but in direct opposition to the interests of thousands of other consumers throughout the entire State of California. And this because they claim they have made contracts with the company, or the company has made representations, that will compel it to furnish water to them for less than it is worth, and on such terms as will be absolutely ruinous to the company. Not only this but they seek to establish the doctrine that as to all other

property owners under the system, not yet supplied with water, the company may refuse to furnish them water unless they will contract with it to pay such rate as it may fix, without limitation, and that they can have no redress under the constitution or statute in the way of having the rates fixed by the public authorities. Such an outcome would be entirely satisfactory to the company, if we believed it could be finally maintained and upheld, not only as between the company and the consumers now before the court, but as to all consumers. But we shall attempt to show, hereafter, that this must be impossible under the law and under the express allegations of the bill of complaint and answer, as to the nature of this corporation and the purposes for which it was organized.

With these few preliminary observations we pass to a discussion of the specific points made and argued by the defendants. And first we address ourselves to the brief of Messrs. Haines & Ward.

II.

It is said in very general terms, and without argument, that an exception for impertinance must be supported *in toto* or it must fail, and, that, therefore, exception "First," numbering 47 paragraphs, and exception "Seventh," cannot be supported.

But both of these exceptions set out the different parts of the answer claimed to be impertinent, separately and numbered, and each of said parts are excepted to severally and separately. This amounts to a several and distinct exception to each of these separate parts, and may each be ruled upon separately.

III.

The second exception is claimed to be a pure misapprehension on our part "of the theory upon which one class of the defendants have pleaded the purchase from the company of lands, with the appurtenant easement in its diverting and distributing system; and upon which another class of defendants, not purchasers of land from the company, have bought easements under the form of contract set forth on pages 17 and 18 of the bill (answer)."

We could only judge of the "theory" upon which these facts were alleged from the facts themselves, and took the one indicated by the exception, as the most reasonable, in fact the only reasonable one. But, as the learned solicitors, who are also consumers and defendants, expressly, and with some warmth, repudiate any intention to urge such a defense, and the only one, we believe, that could be supported by any show of reason, the discussion of that view of the subject may as well be left out of the case from this on.

IV.

Unfortunately the solicitors, whose brief is now under consideration, are defendants in this action, as well as solicitors, and their brief is characteristic of a party, rather than an attorney. They cannot look with judicial fairness upon the questions involved, and their whole argument is tinged with a tone of bitterness that is not pleasing. And we must say, with all respect for the gentlemen who wrote this brief, and for whom we entertain the most kindly feelings, that their brief is the most remarkable pro-

duction, and advances the most unheard of, or hitherto unsuspected, theories (for they are but theories) on these important water questions that have yet come to our notice. And if they can be maintained, not as mere theories, but as actual law, the constitution of this State, and the statutes enacted under it, for the protection of the waters of this State will be no better than so much blank paper. And this remarkable position is attempted to be maintained upon the grounds: *First*, That the company claims to have the unlimited right to fix its own rates until the same are fixed by the board of supervisors, as provided by law; *Second*, That to leave the fixing of the rates to the board of supervisors is to put it in the hands of a public body which will be corruptly influenced by the corporation to fix unreasonable rates; and *Third*, That to put this power into the hands of such board is to "extend the power of taxation in a new and subtle form."

As to the first of these it has never been claimed by us that the company has the power to fix the rates *without limit*. We concede that the rates must be *reasonable*. But our first contention is that the remedy, if the company establishes an unreasonable rate, is for the consumers, or other citizens, to apply to the board of supervisors to make reasonable rates. The right to apply to the board of supervisors is given to the citizens alone, and not to the corporation. Why? Because, *until the rates are so fixed, it is given authority to establish its own rates.* This being so no necessity for an application by it, in the first instance, can exist.

But the moment it establishes what the consumers regard as an unreasonable rate they may apply to the board of supervisors to fix such rates and thereby abolish the rates established by the company. And if the board of supervisors fix an unreasonable rate the consumers, or the company, may appeal to the courts, and, if the rates are found by the court to be unreasonable, have the same set aside. The statute itself is the strongest argument in favor of our position that until the rates are fixed by the board of supervisors the company may establish and re-establish its own rates. If this were not so the statute would give to the company, as well as to the consumers, the right to apply to the board. But it does not. It limits the right to the consumers for the very good reason that until the rates are fixed by the board the company may establish and change its own rate. And this is evident from the further provision that after the rates are once fixed by the board *either* the consumers *or the company* may, after the expiration of one year, apply to have the rates changed or abrogated.

Stat. 1885, p. 97, Sec. 6.

We do not appreciate the assumption, so warmly urged by counsel, that the submission of the rates to the board of supervisors, a body representing the persons making the application, and elected by them, is unjust or unreasonable, or that it will or can, work any hardship on them. Either the consumers, or the company, may, as we contend, apply, ultimately, to the court to determine whether the rate is reasonable

or not, and if not, to have it set aside. But until the board of supervisors has acted there is nothing upon which a court of equity can proceed, further than to declare the right of the company to collect the rate itself has established, and to prevent the consumers from harassing the company by a multiplicity of actions at law to prevent the collection of the rates when they have not resorted to the remedy given them by statute. The doctrine that a court of equity will not aid a party where he has a plain, speedy and adequate remedy at law, is too well established to require the citation of authorities to support it. And this case, so far as it calls for a decision in favor of the defendants, as against the rates established by the company, is clearly within the doctrine stated.

With respect to the second ground urged by counsel it can hardly be assumed by this court, as a ground upon which to relieve the defendants from the effect of laws enacted for their benefit, that the San Diego Land and Town Company would corrupt the board of supervisors to procure action favorable to it, or that the members of the board would be, or are, susceptible to such influences. Such an argument is an insult to the parties concerned and to the intelligence of the court.

The third proposition that the power given the board of supervisors to establish the rates is an "extension of the power of taxation in a new and subtle form," we confess we do not understand. It cannot be consistently claimed that a consumer is entitled to be furnished with water, by and through the plant

of the company, for nothing, although, as we shall show farther on, this is the real position taken by the defendants. They must certainly pay something for the furnishing of the water to their lands. The law has, for their protection, provided how the rates shall be fixed by the public authorities, in case consumers are not satisfied with the rates established by the company. We do not understand upon what ground this can properly be characterized as a new and subtle species of taxation, or be held to be unjust to the consumer.

It must be borne in mind that all of this line of argument is based solely upon what *might* be the result to the consumers, and that neither in the answer of the defendants, nor in the long and able briefs of their solicitors, is it alleged or claimed that the rates established by the company and sought to be upheld in this suit are unreasonably high. Their sole contention, throughout, is, not that the rates established by the company are unreasonable, but that it has made contracts and representations by which it is bound to furnish the water, not at a reasonable rate, but at a continuous loss, and that by purchasing land from the company some of the defendants have acquired the right to have the water furnished to their lands for the bare cost of operation. In other words, that, for the services in supplying the water, and the use of its plant for that purpose, and the gradual wearing out of the plant, in the service of the consumers, the company shall receive nothing. This is their whole case, stripped of the verbiage, subtlety, and abstruse reason-

ing of the solicitor who wrote the brief we are now answering and of which he is a master. In his tortuous efforts to establish a doctrine so utterly unreasonable and unjust, we will attempt to follow him. We have said this much in order to remove from the discussion of the real questions involved, his assumption that to apply the plain and explicit law to this case would result in hardship, and that therefore the court should disregard the law and give these defendants some special relief that could not be extended to other suitors.

V.

In the fifth subdivision of their brief counsel attempt to maintain that certain of the defendants have acquired from the company a servitude in its entire system by the purchase from it of certain of its lands, and that the right thus acquired entitles them to the continuous flow of the water, and vested in them an easement in the distributing system and reservoir and dam, and entitles them for all time to receive the water through the system upon payment of the bare operating expenses. Their position is stated as follows:

"When it sold and conveyed parcels of its lands to certain of these defendants, unless the grants contained an express reservation of that portion of the corporeal estate which consisted of the water supply led upon the land, such supply passed with the land. Upon familiar principles, so much of the pipes as lay within the boundaries of the granted land, passed with the fee and in fee; and as to the reservoir and so much of the conduit as led up to and lay outside the boundary of such land, upon the severance, there sprang up a relation of servient estate to the land granted, as the dominant estate; in other words, the servitude upon the water system, so far as such system was not actually within the land granted, passed by the grant as an appurtenant easement; and it passed without express mention, and even without the use of the term 'appurtenant' in the deed."

Numerous authorities are cited to support this novel contention. But the authorities referred to apply not to *quasi* public corporations, selling and distributing water under the constitution, but to private sales of land and water where the seller is the *private owner* of the water he sells as well as the land to which the right to the water is appurtenant. The doctrine that a water right held in private ownership, and attached to real estate, passes as an appurtenant upon a conveyance of the land, is so well settled that the learned discussion of the subject, by counsel, and the citation of authorities, was wholly unnecessary. The trouble is that both the discussion and the authorities are foreign to the facts and issues in this case, except upon the theory of counsel that the San Diego Land and Town Company is a private corporation and owns the water rights to the Sweetwater river, not by appropriation for public use but as a private individual, and for its own private use. Besides, it does not appear by the answer, and as matter of fact it is not true as to most, if not all, of the defendants, that *at the time they secured their conveyances from the company* the water had been placed upon or become appurtenant to the land they purchased. On the contrary they took the water from the company as an appropriator of water for the public use, placed it upon their lands themselves, and have ever since paid an annual rental therefor, and in every way treated and regarded the company as an appropriator of water for sale and distribution under the constitution and laws of the State. We do not mean to be understood that by the application of the water to their lands, whether the

same was applied before or after they purchased the same, the defendants acquired no rights to the use of the water. But it was in no sense such a right as they now claim. The right they obtained is clearly defined by Section 552 of the Civil Code of this State. The effect of this and other provisions of constitutional and statutory law, affecting the rights of the parties, will be considered in reply to other parts of the brief of counsel. It is enough to say, in this connection, that the right given a land owner, by applying the water to his lands, whether he purchases the land from the company or not is the right to the continued or perpetual flow of the water "*at such rates and terms as may be established by said corporation in pursuance of law.*"

Civil Code, Cal. Sec. 552.

The terms upon which the land owner is entitled to the perpetual flow of water remains the same as it was originally, under the section cited, except that by the constitution and statutes, since enacted, the rates to be paid may, at his instance, be fixed by the public authorities, in which case he is bound, in order to preserve his right, to pay the rates so fixed, instead of the rates "established by said corporation in pursuance of law."

Stat. 1885, p. 95.

And as this right to the perpetual flow of the water, on the terms prescribed by law, is not assailed in this suit, the whole discussion, relating to such right, is outside of the issues and only tends to cover up and

confuse the real questions involved. We do not controvert their claim that they have a water right but contend that it is conditioned upon their paying the company a reasonable annual rate for the water used. And whether the annual rate fixed by the company is or is not a reasonable one, is the only question in the case, provided the defendants have the right to call upon this court to determine this question before applying to the board of supervisors for relief. If not the complainant has the right to have it so determined and to an injunction preventing the defendants from harassing it with a multiplicity of separate actions at law to prevent the company from collecting such rates. The questions are wonderfully simple but the argument of counsel is so abstruse, and beside the subject, as to be incomprehensible to the ordinary mind. It may be said, with perfect truth, that unless this court shall hold that the San Diego Land and Town Company is a private corporation, dealing with water appropriated by it as such, every word said in the long brief of counsel is immaterial, and aside from the questions involved in the issues. And it is equally true that if it is shown to be a private corporation, and not subject to the constitution and statute, respecting rates, it is only necessary for the defendants to prove that fact, in order to defeat the complainant's cause of action, as his bill proceeds wholly upon the theory that it is a public corporation engaged in selling and distributing water to the public, and everything else in their brief is superfluous.

VI.

This brings us to the question, discussed by counsel, as to the effect of Article XIV of the constitution of California and the statute of 1885. It may be said, at the outset, that if the Land and Town Company is a private corporation, and has been dealing with the defendants as such, the article of the constitution and the statute referred to, have no bearing whatever on the rights of the parties. It is only such waters as are "*appropriated for sale, rental or distribution*" that are declared by the constitution to be "*a public use*"

Const. Cal. Art. XIV Sec. 1.

It is only the "right to collect rates or compensation for the use of water" so appropriated that is declared to be a franchise that "cannot be exercised except by authority of and in the manner prescribed by law."

Const. Art. XIV, Sec. 2.

And it is only the sale and distribution of water so, and for such purpose, appropriated that is attempted to be regulated by statute.

Stat. 1885, p. 95.

Therefore the first inquiry in the orderly and logical discussion of this question must be: Was the water in controversy "*appropriated for sale, rental or distribution* is the same "*a public use*" and "*a franchise that cannot be exercised except by authority of and in the manner prescribed by law?*"

If not these constitutional and statutory provisions do not affect the rights of these parties in the least. Their

rights must be controlled by the law, as it exists, independently of these provisions.

Of course upon the exceptions to the answer, the question as to the nature of the corporation, and its rights in the waters appropriated by it must be determined from the allegations of the bill and answer alone. The bill alleges:

"That the said company is and has been during said times the owner of valuable water, water rights, reservoirs and an entire water system, *for furnishing water to consumers*, for domestic, irrigation and other purposes, for which water is needed for consumption, and of a franchise for the impounding, sale, disposition and distribution of the waters owned and stored by it, to the defendants and other consumers, and to the city of National City and its inhabitants."

Bill of complaint p. 2.

And again:

"That by the expenditure of said large sum, said company has procured and owns *subject to the public use and the regulation thereof by law*, water, water rights, a reservoir site and reservoirs * * * and has constructed and laid therefrom its water mains necessary to supply the defendants and their lands hereinafter mentioned, and the said city of National City and its inhabitants, with water and has constructed and put in mains, pipes and all other things necessary to connect said water supply with the premises and buildings of the defendants, and each of them, and with the premises and buildings of said city and its inhabitants, and to furnish them, and each of them, with water, and was at the times hereinafter mentioned furnishing them and each of them with water."

Bill of complaint p. 5.

It can hardly be contended that the bill does not show an appropriation of water for sale, rental and distribution.

But the answer of the defendants is even more explicit in this respect. It alleges as follows:

"They deny that said corporation is, or at any time was, the owner of the water or water rights, as alleged in the complaint, *otherwise than as the appropriator, under the constitution and statutes*

of the state of California, and the acts of congress, of the water of the natural stream in the said county of San Diego known as the Sweewater River. *And they aver that the purposes of such appropriation were for sale, rental and distribution to the public.*"

Ans. page 3, line 27.

Notwithstanding this plain and explicit denial that the company owns any water, or water rights except as an appropriator for the public use and the equally explicit affirmative averment that the purpose of the appropriation was for sale, rental and distribution to the public in the exact language of the constitution and statute, their whole argument in support of this answer is founded upon their unwarranted assumption, in the face of their sworn answer, that the company *was* and *is* the owner of the water and water rights free from any obligation to the public and, as such owner, was authorized to, and did, contract the same to them, and that the company is in no way affected by either the constitution or the statute.

And upon what ground do they repudiate their own averments as to the nature of the corporation and its interest in the water. Solely on the ground that the company owned a large portion of the lands covered by and to be benefited by the system and the development of the water. But what difference this can make, as to the rights, duties and liabilities of the company, in appropriating and disposing of the water to the public, has not yet been explained. Once in the history of the state a corporation, situated precisely like this one, attempted to take this same ground but the Supreme Court held, unqualifiedly, that the fact that it was partly organized as a land

company and owned lands under its system, did not affect its obligations to the public, as an appropriator of water on the ground that by its incorporation as a water company it had impressed upon it a public trust —the duty of furnishing water to the public.

Price *v.* Riverside Land and Irrigating Company, 56 Cal. 431.

And this court has, in a very late case, held this same corporation amendable to the provisions of the constitution, and bound by an ordinance of the city of National City fixing water rates.

San Diego Land and Town Company *v.* National City, Fed. Rep, May 2, 1896.

Counsel rely upon McFadden *v.* Board of Supervisors, 74 Cal. 571. But that was a case where a corporation appropriated the water for the use of its own stockholders, only, and not for sale, rental or distribution to others. And it was for that very reason, and that only, that it was held not to be within the constitutional and statutory provisions for fixing rates. Not only is it expressly averred, both in the bill and answer in this case, that this company was organized for the sale, rental and distribution of water to others, but its articles of incorporation, as set forth in the answer provides that the purpose of its organization, in part was "the supply of water to the public," and the answer of the defendants shows conclusively that they have been buying water from the company, and paying an annual rental therefor, ever since the company commenced to do business. It seems idle, under such circumstances, and such is-

sues, to discuss the question whether this company was and is a corporation furnishing water subject to the provisions and restraints of the constitution and statutes or not, and if it is such a corporation what becomes of the elaborate and learned brief of the solicitors for the defendants. The foundation upon which their whole argument rests has crumbled away and the argument itself comes to naught. But they claim that they have purchased and paid for the "servitude"—the "water right" and therefore "the element of net revenue is for all time eliminated from the rates." That is to say: "When a party purchases a water right, or even where the water is voluntarily made appurtenant to his land by applying the same thereto, without compensation, he is for all time entitled to the water without paying the company a single dollar therefor." If there is to be no "net revenue" the company must, necessarily, receive nothing. If only enough is paid to cover actual operating expenses, and maintenance, as they claim, the company necessarily receives nothing for furnishing the water, and the necessary decay of its plant, each year, is a net loss. It is alleged in the bill, and not denied in the answer, that the distributing system of the company is perishable and requires to be replaced once in sixteen years. If so it must, under counsel's construction of the law, receive no compensation for the water it furnishes but must lose its entire distributing system within sixteen years. Certainly a court of equity must be driven to such a construction before adopting it.

But this leads us to inquire what is the water right that a party gets by purchase, or otherwise, under the laws of this state. It seems to us that the whole question is answered by section 552 of the Civil Code of this State which provides:

"Whenever any corporation, organized under the laws of this State, furnishes water to irrigate lands which said corporation has sold, the right to the flow and use of said water is and shall remain a perpetual easement to the land so sold, *at such rates and terms as may be established by said corporation in pursuance of law.* And whenever any person who is cultivating land on the line and within the flow of any ditch owned by such corporation, has been furnished water by it with which to irrigate his land, such person shall be entitled to the continued use of said water, upon the same terms as those who have purchased their land of the corporation."

The section defines a water right, such as the defendants claim to have acquired. It is the right to the perpetual easment of the flow of the water "at such rates and terms as may be established by said corporation, in pursuance of law." It protects the land owner from the injury of having the water supply cut off from his lands, after the same has been planted, or improved, as a result of acquiring the use of the water. It secures the use of the water to him, upon the payment of the rates established as prescribed by law, as against subsequent sales beyond the capacity of the system, and he may enjoin the corporation from disposing of and attempting to furnish water to others beyond such capacity, and thereby imperiling his right to the perpetual flow of the water to which he has become entitled. It secures the owner of the water right against having his water supply cut off or diminished. Such a right is justly regarded as

a valuable one. It has been the subject of purchase and sale ever since water has been furnished by one person or corporation, to others. The right of corporations, or other water companies, to sell this right has been recognized and enforced by the Supreme Court of the state.

Fresno Canal Co. *v* Rowell, 80 Cal. 114.
Fresno Canal Co. *v.* Dunbar, 80 Cal 530.

Until the late decision of this court in San Diego Land and Town Company *v.* National City, the existence of such a right, and the power of water companies to sell and dispose of it, was never questioned. The statute of the State expressly provides for it, and protects the owner of the right in its continued enjoyment. Both the companies and their consumers have always regarded it as a tangible and valuable property right. We cannot believe that the conclusion reached in the case last cited will be adhered to, even by this court, on more mature and careful consideration of the subject. But in this case the question of the existence of such a right is not involved. Both parties maintain that there is such a right and that it has been sold by the company and purchased by the defendants. The sole question here is: *Does the purchase, or acquisition of this right, affect the right of the company to collect an annual rate for the water supplied through and by its system, and, if so, how and to what extent?* The defendants maintain that by acquiring the water right, by reason of the purchase of their land from the company, by having the water placed upon the lands, free of charge, or by purchasing the water

right, they have thus acquired the right to have the water furnished to them, forever, without any compensation whatever to the company for its services and the use of its plant in storing and delivering it. Concealed under the ambiguity of their way of putting it, they are no longer bound to pay rates "on the basis of net revenue." Now what is the result? Every consumer who receives water from the company, upon his lands, becomes entitled, by the mere act of putting the water upon the land, to this water right. It makes no difference whether he pays for the right or not. It makes no difference whether he purchased the land from the company or not. If the company voluntarily places the water upon his lands, by that act alone, he becomes, by virtue of Section 552, the owner of the perpetual easement of the flow of the water. The section referred to places the consumer who purchases his land from the company, and the consumer who does not, but has the water placed upon his land, purchased from another, on precisely the same footing. It is merely a protection against having the water once supplied cut off from his lands. And in both cases, by virtue of the express provisions of the statute, he is only entitled to the "flow and use" of the water "*at such rates and terms as may be established by said corporation in pursuance of law.*" The acquisition of this perpetual right to the flow of the water not only does not relieve him from paying for the water he receives, but the statute, in express and unequivocal terms, while protecting him in the right, provides

as a condition thereof that he must pay such rates for the water as the company may fix.

So we have the law before the adoption of the present constitution, and the enactment of the statute of 1885. It is so plain that all who read may understand. There is no excuse for misunderstanding the code provision, or the right secured by it, both to the consumer and the company. It protects the former in the perpetual flow of the water, and the latter in its right to payment for the water it furnishes. This brings us to the question discussed by counsel:

What effect has article XIV of the constitution, and the statute of 1885 upon the respective rights and duties of the parties.

We maintain that, so far as any question in this suit is concerned, they have no effect whatever except to authorize the fixing of the rates to be charged for the water by some one else besides the company. The right to the water flowing in the natural streams of the state was as much a public use before the constitution was adopted as it is now. So much of the constitution as declares it to be so is a mere constitutional declaration of a rule of law, and a right, already existing. It is so declared as a basis for what follows. What follows are the provisions for fixing the rates to be charged for water furnished. As to water furnished ouside of cities and towns the constitution does not provide, specifically, how the rates shall be fixed, but provides that the "right to collect rates or compensation for the use of water is a franchise and can-

not be exercised *except by authority of and in the manner prescribed by law.*"

Hence the statute of 1885, prescribing the manner in which this franchise of collecting rates shall be exercised and such rates fixed. It is not claimed by the defendants, as we understand them, that section 552 of the Civil Code has been abrogated or repealed by the constitution, or by the statute of 1885. If not, then the water right, or the right to the perpetual flow of the water, when once attached to the land still exists by virtue of that section. Then what effect has the constitution, and later statute, upon this water right, and the terms upon which the use of the water under it may be secured. We answer none whatever, except to *change the manner* in which the annual rates to be charged may be fixed at the option of the consumer As the section of the code stood he was only entitled to the water upon paying the rates, and upon the terms *fixed by the company*. The constitution made the right to collect the rates a franchise and provided that it should only be exercised by authority of and as prescribed by law. It was already authorized by section 552, but no mode of establishing the rates, except by and at the will of the company furnishing the water, was prescribed. By the statute of 1885 the law is so changed that if a certain number of consumers or other citizens are dissatisfied with the rate they are required to pay, under section 552, in order to preserve their right to the perpetual use of the water, they may apply to the board of supervisors and have such board establish and fix the rates. But the stat-

ute went farther, and, in substance and effect, declared that the rates should be so fixed as to return to the company, as *net annual profits, not less than six nor more than eighteen per cent.*, upon the value of its plant and property used in furnishing the water.

Stat. 1885, Sec. 5, p. 96.

But as we have before said unless the consumers see fit to call upon the board of supervisors to fix the rates the right to fix them is still preserved to the company, as under section 552. In other words the consumers *may* resort to their remedy provided by the statute of 1885, or not, as they may see fit. If they do not the company may establish its own rates, whether the rates, so fixed by the company are subject to review, or alteration by the courts, need not be considered in this connection. We are now replying to what is said on the other side as to the effect of the constitution, and the statute of 1885. The question as to the manner of acquiring the water right provided by section 552 is wholly immaterial with respect to the right to collect an annual rate, or the amount to be collected. No law can be found, anywhere, to maintain the contention of counsel that it can have any such effect. All the law on the subject, including section 552, makes the continued right to the use of the water, no matter how the right is obtained, conditional upon the payment of the rates. When the statute of 1885 was enacted the law required the payment of these rates. If it had been intended that any distinction as to the amount to be paid, should be

made, between a consumer who purchased his land from the company, and one who did not, or between one who purchased a water right and one who did not, doubtless such a distinction would have been provided for, but it was not. We submit that, under this state of the law, there is no warrant for the contention of counsel that the defendants should contribute nothing to the company as a profit, or remuneration for its services, and the use of its plant, in furnishing the water. There is nothing in the constitution, the statute, or any adjudicated case, that gives any, the slightest, support to such a doctrine. Not only so but the statute now in force expressly provides that the rates shall be so fixed as to return a net profit of not less than six per cent on the value of the plant.

Besides, it is the undoubted policy of the law that the rates shall be uniform. This cannot be so if one rate is made for the consumer who purchases his land from the company, another for one who purchases a water right for land not obtained from the company, and still another for one who acquired his water right, without compensation, and by reason of the fact that the company has vested the water right in him by voluntarily attaching the water to his land. All three of these classes are represented as defendants in this suit. In the beginning it was supposed that there would be ample water for all the land under the system and no thought of a preferred right, by purchase or otherwise, was thought of. Those who bought land of the company entertained no idea that they were paying for the water, for the reason that their neigh-

bors, who did not buy from the company, were then getting water on their lands without paying a dollar for it. It was only after it became apparent that the supply of water was not sufficient for all, that the preferred right to it was sold as a water right. The idea that the high price paid for the land bought from the company, would, in any way, affect the annual rate to be paid for the water was an afterthought conceived by the imagination of the ingenious gentleman who wrote the brief in this case. And his method of proving it is most remarkable. If the law relating to the supply and use of water can be anything like as complicated and abstruse as his argument indicates, courts and lawyers may as well suspend all efforts to administer the law and adjust the rights of parties under it. But to any one who makes an honest and fair effort to arrive at the object and intention of the law on the subject, it will appear to be exceedingly simple and free from complications. It is just such efforts as that of the learned solicitor for the defendants that confuses the subject and renders it complicated and uncertain.

As to the claim of the defendants that they have, by five years user of the water, obtained, by prescription, the right to the use of the water *at $3.50 an acre per annum* it is too absurd, it seems to us, to need any refutation. They did not need to use the water for five years in order to acquire the right to its perpetual flow. The mere voluntary application of the water to the land of a consumer gave him this right. But the claim that, because the company has, for five years,

furnished him water at a loss, it must continue to do so forever, is a little too much. In fact this whole argument about "easements," "servitudes," "serviant estates," "statute of uses," "dominant estates," etc., etc., if it did not come from a lawyer of good reputation, would be looked upon as a burlesque, so unreasonable does it appear.

VII.

It seems to be the policy of counsel to belittle and narrow the rights of private consumers, in the waters of the State, and to magnify the rights of the company. Therefore they contend that we are wrong in our statement that the company is the mere agent for furnishing the water to the public to which it belongs, and, as it is wholly immaterial in this case, whether we are right or not, in this respect, we submit and let them have their way. But with the utmost inconsistency they abandon this position and argue, at length, that the company is not the appropriator of water at all because the appropriation of water under our law means the actual application of it to a beneficial use, and that this application is made by the consumer, therefore the consumer and not the company is the appropriator of the water. This seems to be logical, and for the purposes of this case, we will modify our position to the extent of saying that the company has *filed upon* the waters of the stream, constructed its dam, stored the water, constructed its distributing system, and provided all the means necessary to carry and supply the water; and the defendants have *appropriated* the same by letting the company run it on-

to their land. There is no occasion for entering into a long discussion over nonessentials like this. It can make no kind of difference *who* actually *appropriated* the water. It has been appropriated, which is quite enough for our purpose. The sole question here is how much is the company entitled to for supplying the water, no matter how appropriated, upon the lands of the defendants, and nothing can be gained by wandering from the subject and discussing pure abstractions.

But they contend further that the company never had any water right, and therefore could not sell any. This is a singular position for counsel to take as they base their whole argument upon the theory that they have bought something we did not own, and could not sell. If we never had any water right, and could not sell any, how could they acquire any rights by buying something that never existed. If they *appropriated* the water themselves, by letting the company put it on their lands, and the company never had any rights therein, by what right can they ask us to carry the water to them, through our system, built with our money, for nothing. Truly these gentlemen need to be protected from their own reasoning. It is the old story of a lawyer acting as his own attorney.

But we must question the accuracy of counsel's statement of facts. They assert that "both the carrier and the consumers in this case have thus far regulated their relations entirely by contract." Nothing could be farther from the truth, in respect of the matter of annual rates. No contracts respecting the amount of

such rates were ever made. The company itself fixed a uniform rate for all consumers, as it had a right, under the law, to do, and every consumer was required to pay it. There was no contract as to such rates.

The only thing that resembled a contract was the application of the consumer for the water, in which he set out the uses for which he desired the water, and the rate established by the company was set opposite each item called for. The consumers had nothing whatever to do with the fixing of the rate. Nor is it true, as counsel states, that "they have dealt with the subject in the way of their race, treating the whole matter as of private and not state initiation". The company has never, at any time so treated the subject, nor do we believe a single consumer, not even the solicitor who wrote this brief, ever thought of treating it as a matter of private contract, or control, until he found it expedient to take that position in this case. It is a position now taken for the first time in all of the controversies between the company and its consumers. But if the statements were true their attitude respecting their rights and duties could not alter the law.

It is equally untrue that, "all at once the 'carrier' cooly ignores all contracts it has entered into and all grants it has made, repudiates all rights that have vested." It has violated no contract, because it never made any, with respect to the rates it should charge. No such contract is alleged in the answer nor was any such ever made. It has not, nor does it now, repu-

diate any of the vested rights of the defendants. These assertions are wholly without foundation and could only be made with a view of prejudicing the mind of the court. The company accords to the defendants all of the rights they have in the water and has never questioned them, and its conduct in its dealings with the defendants will compare most favorably with theirs. It is simply trying in a legal way, to get such a rate for furnishing water to consumers as will save it from ruin. They, on the other hand, not denying that the rate it has established is a reasonable one, are endeavoring to take advantage of mere representations made by the company when it first commenced business as to the price at which it could furnish water.

These gentlemen are greatly addicted to splitting hairs. We said, in our opening points, that the company was the agent of the *public* in furnishing the water. They assert that it is not the agent of the *public* but of the *consumer*.

Well, we supposed that within the meaning of the law, the consumers were the public. But we must have overlooked the importance of the distinction between *a* consumer and consumers in the aggregate, or the public, for counsel assert very gravely that "*this changes the whole face of the thing.*"

We can answer with perfect frankness the inquiry of counsel, "what has become of the *water rights* which the bill avers are *owned* by the respective defendants?" So far as we have any knowledge on the subject the respective defendants still own them. They may have

parte I with them since this suit was brought, but, if so, we have not been notified of the fact. As to the further inquiry: "What element in, or constituent of, the water rights, does the bill allege to have been acquired by the defendants, by purchase or otherwise, from the company." We must refer counsel, and the court, to the earlier pages of this brief. We have there explained our idea of the right to the perpetual use of the water, as provided for by section 552 of the Civil Code. It is simple enough and ought to be easily understood. It is not "moonshine" and so far as we know, until the brief of counsel was written, it was not suspected that there was any "huge delusion" on the part of the defendants with reference to it. If the defendants were now asked to surrender the perpetual right the section referred to gives them, and what is denominated a "water right," we apprehend they would treat it as anything but moonshine. It is justly regarded by all of them as a most valuable right, without which their lands would be of little value. But counsel's idea of a water right is peculiar. They say:

"We venture to believe the more rational explanation is that the company was selling, and, if you please, giving away *servitudes upon its works* and that this element of the water right is the precise thing of which defendants have, by purchase or otherwise, become the owners through their dealings with the company; *the use of the water they get under the constitution and the laws, on their own merits, by using it, and not from the company.*"

They have labored to show, in the earlier pages of their brief, not that they have purchased, or otherwise acquired, a water right such as we have attempted to describe, and such as the code guarantees to the con-

sumer, but that they have in some mysterous way *become the owners of a part of the reservoirs, distributing system and other property* of the company. We have not been able to extract from the mass of verbiage and fine spun theories, contained in their brief, just what their claim of ownership is. But their interest in our plant is easily understood. It is the simple right to the perpetual flow of the water through our pipes, coupled with the obligation on our part to keep the system in such condition and repair as may be necessary to supply the water. You may call it an easement, as it is called in section 552, or whatnot. There is nothing in a name. That is the right, plain and simple. But it makes no kind of difference, in this case, what it is. It is a right that is conditioned upon paying an annual rental, or rates, for the water furnished, or if it pleases counsel better, for the services of the company and the use and the wear and tear of its plant in supplying the water. And this rate, we remind counsel once more, is the sole and only thing in controversy in this case. Therefore all of their fine spun theories may be important in an educational way, but the question as to the exact nature of the rights of the defendants, and the corresponding duties of the company, are wholly immaterial and confuse rather than aid in arriving at an intelligent and just conclusion upon the real and only question presented by the issues.

For the reason just suggested we regret the necessity of following counsel in their long and wearysome discussion of what they understand by a "public

use" and their analysis of the decided cases in Colorado as to the rights of the public generally and of individual consumers in particular. It does seem to us to be superflous and a pure waste of time so far as this suit is concerned. Indeed, if we should concede the correctness of the cases relied upon, from another State, and under a different constitution, and every deduction of counsel therefrom, we are totally unable to understand how it could affect this suit. Their claim that they have an easement in ~~that~~ the perpetual flow of the water through our system is not a controverted question in the case. Our only claim is that for our services and the use of our plant in bringing the water to, and delivering it upon their lands they should pay us a reasonable compensation. They concede they should pay us enough to cover the operating expenses, while we say they should pay us the operating expenses and something additional as compensation for storing, carrying, and delivering the water, and to make good the wear and tear of the plant. This seems a very simple question, not depending upon the particular *nature* of their rights in the water, or in the system, nor of the obligation of the company to them.

But we recognize the fact that the court may take a different view of the questions involved, and for that reason, and that only, we feel it necessary to enter upon the discussion, to which we have been invited by counsel. The Colorado authorities, relied upon, certainly sustain their position that the company is not the "proprietor of the water diverted," if it be con-

ceded that this is a *quasi* public corporation engaged in the sale, rental and distribution of water, and therefore dealing in the "public use" mentioned in the constitution, but strangely enough the very fact that it is such a corporation, is the one they are strongly combatting. It is upon the very ground, assumed by them, no doubt erroneously, that this a *private* corporation dealing with its own private property, about which it has the power to contract, and has actually contracted with the defendants, that they rely most strongly. It is upon this ground that they strenuously maintain that neither the corporation nor the board of supervisors have any power, under the constitution or statutes, to fix the rates to be charged by the company. Why they have adopted this line of authorities, considering their own proposition, is beyond our comprehension. But conceding the effect of their authorities what do they establish and how do they become material to this controversy. They simply hold, so far as they affect the question of rates, that the rates to be paid are not *for the water* which already belongs to the consumer as one of the public, but as *compensation for transporting the water.*

See quotation from Wheeler *v.* Irrigation Co., 17 Pac. Rep. 487, their brief p. 33.

Very well this is entirely satisfactory to us. If they pay us the rates to which we are entitled, in any view that may be taken of it, they may charge it up to transportation or any other account they may think proper. Only let them pay us just rates and we will not quarrel with them about the non-esential question

whether they are paying us for *our* water or for *transporting their* water.

But they go further and maintain that it is not the act of diversion on the part of the company that constitutes an appropriation of the water, but the actual application of it to a beneficial use, in this case, the application of it to the lands of the consumers. It may be conceded that the appropriation is not *complete* until the water is so applied. But each successive act necessary to bring the water onto the land, and thus apply it to a beneficial use, is a part of the act of appropriation, including the filing upon the stream, construction of the dam, and storage of the water, and the construction of the pipe or pipes necessary to conduct it to the land, all of which is necessary to the culminating, or final act of applying the water to the land. And all of this absolutely necessary work is done by the company, and at its expense. And for all this it should be paid a reasonable compensation, and it is so provided by law. But, not because it is material here, but for the sake of accuracy, and that we may not be led into a false position, we do not admit that the position taken by counsel that *as between individual consumers* taking water from a company like this, there is any priority of right, is correct. The latest case in Colorado, directly on the point, is to the contrary.

Wyatt *v.* Larrimer &c., Ir. Co., 29 Pac. Rep. 906.

This was a case decided by the court of appeals. On appeal to the Supreme Court, in the same case, it was reversed on the ground that the court of appeals

had held that the water company owned a proprietary interest in the water. But as to the priority of rights as between consumers taking from the company, no ruling was made on the appeal. The true doctrine we think is that *every* consumer, no matter when he acquires his water right, may protect such right by preventing the company from selling, or attempting to sell or deliver water, beyond its capacity, and thereby cutting off any of the supply of water to which he is entitled.

Wyatt *v.* Larrimer &c., Ir. Co., 33 Pac. Rep. 144.

But until this water right is thus invaded he has no ground of complaint, and each and all of the consumers are alike affected by such oversale.

What counsel is pleased to call the "spurious view" of the "public use," under the constitution, to the effect that a corporation may continue to sell water indefinitely, and beyond its capacity to furnish what water is needed for all its consumers, and thus compel them to prorate and divide up an insufficient supply, is a view suggested by counsel alone. No such claim has ever been mentioned or even thought of by us. Nor do we contend that the consumer has not a fixed interest in the water works to the extent that he may compel the company to keep it in repair and use it to supply him the water to which he is entitled *provided he pays the reasonable rates therefor as fixed pursuant to law.* It is this proviso that counsel are attempting to escape. And if they had kindly confined

themselves to the matter in controversy much labor and confusion might have been avoided.

So we agree with counsel that the defendants each have a right to the water, or a water right, which may be sold with the land, and, so long as they, or their assigns, or grantees, pay their water rates they are entitled to receive it through the company's system. We do not admit, however, that this gives them any property interest in the plant itself. Their sole right is to have the water carried through the plant by the company, its owner. So far and no farther have they any interest in the plant itself. We have, for the purpose of this argument admitted that the company has no proprietary interest in the water, but it does own the plant constructed with its own money, and the defendants have no proprietary interest in such plant.

It will be noticed that in the Colorado decisions, which counsel fully adopt, it is held that the corporation furnishing water is both an "intermediate agency existing for the purpose of aiding consumers in the exercise of their constitutional rights, as well as *a private enterprise prosecuted for the benefit of its owners.*"

See their Brief p. 38.

But counsel wholly overlook the latter capacity in which the company acts. They seem to look upon it as a purely charitable organization, operated for the sole benefit of the consumers, and not entitled to any "net profits."

VIII.

We are pleased that counsel should admit, albeit the admission comes too late to save unnecessary labor, that they have at "perhaps undue length" cited decisions to show "what opposing counsel seem to admit." They take it that they have proved that the company "has no title to the water diverted, has no water to sell." They say:

> "It follows, with unerring certainty, that if the carrier may make a contract of sale, or rental, with the consumer at all, the subject of such contract is not the water, and must therefore be some interest in the water works."

There is some question as to the "unerring certainty" of this proposition, but it is certain enough for present purposes. But the material question is, *what* interest the consumer obtains in the property. We think, laying aside the matter of "easements" "servitudes," and the like, which only tend to make this unerring certainty uncertain, the interest of the land owner in the plant is easily enough understood. As we have said before it is the right to have the water, for which he has secured the perpetual right, flow through the company's system and to have the plant maintained, and operated, for that purpose. The perpetual right to this water he has paid for, if he got it by purchase, or has obtained without consideration, if it has been voluntarily annexed to his land. But for the services of the company in storing, carrying and delivering the water, and the expense of operating the plant he must *pay the rates fixed as prescribed by law.* There has been no contract relating to the rates necessary to pay for this service nor has it been paid for. There

can be no pretense of anything of the kind. They beg the question and attempt to cover up the real question at issue here by maintaining that when they paid for the *water right* they obtained what they did not pay for, the services of the company and its plant in storing, carrying and distributing the water. The perpetual right to the flow of the water is regarded as so important, as we have seen, that it is preserved to the land owner by positive law, but on the condition that he pays the rates fixed by the company for furnishing the water. The difference between the two is so clear that we wonder they should be confused or mistaken one for the other. It is wholly unnecssary to inquire, in this case, whether a contract for a fixed annual rental would be legal or not, for the reason that no such contract is set up in the answer, nor has any such contract ever been made. The only *contracts* alleged are to pay the rates fixed pursuant to law and the like. There are only a very few of the defendants who have contracted for a water right. Nearly all of them have obtained the water right provided by section 552, and by operation of that section, which, as we have shown is the right to the perpetual flow of the water at the rates and on the terms fixed by the company. The sole ground upon which they can claim that the rates cannot be changed by the company is that it represented that the water would be furnished at $3.50 an acre per annum. This shows conclusively that they understood that they must *pay* for the water as it was furnished to them. And there is no element of estoppel in the transaction. All of

the parties concerned must have known, as a matter of law, that any such representations could not be binding, as the law explicitly provides how these rates may be fixed and it is not by contract. And no contract fixing them permanently, much less any representation that they would be maintained, permanently, at a given figure, could be legally binding.

We are ready to concede that the water right, or the right to have the perpetual flow of the water attached to the land, is a matter of contract, and that a contract made by the company therefor, or the putting of the water on the land, would be binding on the company. Counsel call it a "freehold servitude," but whatever it is, it is always subject to the payment of the annual rates as prescribed by law, and cannot affect those rates in the least. The Wyatt case, relied upon by counsel involved only the question whether consumers who had bought water rights could enjoin the company from selling water, beyond its capacity to supply, to other persons. The court held they had such right, and of the correctness of the decision we have no doubt. But the case has no bearing whatever in this case except to confirm what we maintain that the water right is a separate and distinct thing from the services of the company in storing, carrying and delivering the water, and that it was the water right, and that alone, that the defendants acquired, and that in order to have the water carried for them and delivered on their lands they must pay for such services, and the use and wear and tear of the plant. Such is the law under Section

552, and such was the law before the enactment of the codes.

Stat. 1862, p. 541, Sec. 3.

There has never been a time under our law, when corporations dealing in water were not regarded as organizations operated for the profit of their stockholders and entitled to such rates as would secure them such profit.

It has never been claimed by us that the regulation of the rates by the board of supervisors is inconsistent with the acquisition of the easement, so called, appurtenant to the land. On the contrary we agree with counsel, fully, that they are separate and distinct things, but that the enjoyment of the easement is dependent upon the payment, by the land owner, of the rates fixed as prescribed by law.

IX.

It is an unwarranted assumption on the part of counsel that, at the oral argument, we seized upon the decision of this court, in the National City case, to the effect that there is no such thing as a water right, as a judicial sanction for the repudiation, by the company, of its contracts. We say frankly that we do not agree with the conclusions reached in that case. We simply remarked that the court had held in the case referred to that there was no such thing as a water right, and that we would leave it to counsel on the other side to convince the court that it was wrong, because, if there was no such thing as a water right, the defendants could claim no advantage growing out of the purchase of a thing that had no exist-

ence. We maintain, as we have done heretofore, that there is such a thing as a water right, that the Land and Town Company has, in some cases by contract, and in some cases by operation of law, granted such water rights to the defendants, and that they now own them. If this be what counsel means by repudiation of a contract, under judicial sanction, or otherwise, then the company has repudiated its contracts. We maintain further, and in harmony with the position of counsel that this water right,or the right to the perpetual flow of the water, conditioned on the payment of reasonable rates, is a valuable property and that to compel a company without compensation to put water on ones land, thus vesting him with this water right, by operation of section 552, is confiscation plain and simple and of the rankest kind. This is our position that need not be misunderstood. If it is not a thing of value then it is not confiscation for any one to appropriate it, either with or without judicial sanction. But however this court may look upon it counsel cannot consistently disagree with us for they maintain the existence and value of the right as strongly as we do and they, being defendants as well as solicitors in this case, know its value. With them it is not a matter of speculation We need not repeat what we understand this water right to be. Counsel profess not to understand what is meant by a water right. Section 552 of the Civil Code will inform them if they will only read it. They attempt now to maintain that because they have secured a water right, in most cases

for nothing, they are forever freed from paying the company anything for storing, carrying and delivering the water on their land, or for the wear and tear of the plant consequent upon its use for their benefit. No sham assumption of indignation at the claim made by the company can conceal the injustice or absurdity of such a proposition. Their claim is that their acquisition of this water right, in most cases for nothing, should be construed as being "grants of freehold servitudes on the system for price paid," and that the bearing of this upon the 'annual water rates allowed by law' is that it eliminates from them the whole element of net revenue." In plain terms because they acquired the right to the perpetual flow of the water, through the company's system, in case of most of the defendants *for nothing* the company must, for that sole reason, store, carry, and deliver the water for all time and wear out its plant in their service *for nothing*. The proposition is so utterly unjust as to shock any one possessed of common honesty and fairness. There are, in round numbers, 700 acres of land that was purchased from the company, and the water right acquired in that way, by operation of section 552. Something over 900 acres were owned by other parties, and for these the water right was acquired by operation of the same section by the water having been put upon the lands voluntarily and without compensation, by the company. Those who purchased from the company did not, in fact, pay a dollar more for the land because it could supply the water. They would have been compelled to pay ex-

actly the same price if they had purchased land under the system from any other owner. All lands in the neighborhood, whether owned by the company or not, sold for the same price. No one who bought from the company understood that they were paying a dollar for a water right. They paid for the land at exhorbitant prices, in boom times, and expected that when they wanted it they could get the water at the annual rates by merely connecting their service pipes with the mains of the company. Their pretension now that they ever bought any interest in the plant of the company, or ever understood any such thing, is the purest kind of hypocricy invented for the occasion.

Counsel refers, frequently, to contracts and their construction. No contracts, such as they assume were made, are alleged in the answer, nor do we know of any such. The only contracts alleged in the answer are those referred to in our point II, made in the opening, and copied above. They expressly bind the consumers making them to pay the annual rates. With respect to those defendants who bought their lands from the company, and those who secured their rights by having the water put upon their lands, have made no contracts with the company, and none are alleged. They simply got their water by operation of section 552 and on the condition that they pay the rates fixed by the company pursuant to law. If they claim the water right by virtue of that section, and they have no other claim to it, they must take it with the annexed condition But their claim amounts to this: That the consumers by securing the water

rights, no matter how, become thereby *the owners* of so much of the *plant* as well as of the water, and that they, as owners, are only bound to pay for operating and maintaining it. But the trouble with this position is that they hold the company bound to operate the plant which they own, be responsible for the delivery of the water, and all failures to deliver it, put in a new system when this one wears out, and in every way act as if it were the owner of the plant, and that it must do all this without any "net revenue," or to speak more plainly, without any profit or compensation to its stockholders who are not only the owners of the stock but personally responsible for all its debts and liabilities. To such absurdities does counsels argument lead them.

X.

The construction attempted to be placed upon the statute of 1885 is as novel as the balance of their brief. Their whole argument in this case certainly has the merit of being new and original. They say, with reference to this statute, that its provision, to the effect that until the rates are fixed by the board of supervisors, the rates established and collected by the company shall prevail, presupposes, and proceeds upon the theory, that the rates have been *fixed by contract* between the company and the consumers, and that the intention of this particular provision is to confirm and make perpetual the rate so agreed upon, until the board of supervisors fix the rate. That is to say that, as the company cannot apply to the board, it shall always be bound by the contract rate, but that the consumer is only bound until he sees a chance to get

the board of supervisors to help him violate his contract by establishing a lower rate. This is certainly a delectable piece of legislation, so construed, and if counsel are right that this matter of rates is a matter of private contract, the statute might be amenable to the constitutional objection that it interferes with vested rights. It may be, however, that the learned solicitors are proceeding upon the theory that a water company has no rights, because they have all been vested in the consumers as "freehold servitudes." It would seem so.

But this additional theory that the statute of 1885 presupposes a contract fixing the rates, is not only imaginary, but the contrary is susceptible of exact demonstration. The earliest statute on the subject gave water companies power "*to establish, collect, and receive rates, water rents, or tolls,*" but "subject to regulation by the board of supervisors of the county in which the work is situated, *but which shall not be reduced by the supervisors so low as to yield to the stockholders less than one and one-half per cent. per month upon the capital actually invested,*

Stat. 1862, p. 540.

There is no intimation in this statute that the rates or rentals may be fixed by contract.

Following this was section 552, of the Civil Code, which provides that the consumer shall receive the water "*at such rates and terms as may be established by said corporation in pursuance of law.*"

This code provision certainly did not contemplate or authorize the fixing of rates by contract. Probably

this section of the code left the statute of 1862 intact and, in order to establish the rates "in pursuance of law," as provided in the section, the company might fix its rates, as provided in the statute, subject to the action of the board of supervisors. But that is not material. So far we have nothing tending to show the legislative intent to leave the fixing of the rates to contract. But if any such deduction could be made from the statute of 1862 and the section of the code, which is impossible, the question has been forever set at rest by the constitution. The constitution provides that *the right to collect rates * * is a franchise* and cannot be exercised except *by authority of, and in the manner prescribed by law.*"

This, it must be understood, does not apply to the franchise to be a corporation, but *to the right to collect rates.* And it is further provided that this right to collect rates cannot be exercised except by authority of and in the manner *prescribed by law.* Up to the time the constitution was adopted the company was authorized to fix its own rates, subject to the supervision of the board of supervisors. The constitution takes the matter of fixing rates out of the domain of contractual obligations and makes it *a franchise* to be controlled by the state. It seems to us nothing could be clearer than this. But we need not stop here. The statute of 1885 does *prescribe the manner* in which rates shall be fixed and collected. When the statute was enacted, the rates were authorized to be fixed *by the corporation* and not by contract. But the corporation, in fixing the rates, was made subject to the

action of the board of supervisors. However, there was no provision in the statute of 1862, nor in the section of the code, as to the manner of submitting the question to the board of supervisors. This is remedied by the statute of 1885, which establishes the procedure by petition of citizens and notice. With this exception, and the further exception that the amount of eighteen per cent., allowed under the statute of 1862, where the rates were fixed by the board of supervisors, was reduced to not less than six nor more than eighteen per cent., the law is unchanged. In all other respects the statute of 1885 is practically the same as that of 1862.

There has never been a time in the history of this state when this matter of rates for water was regarded as one to be controlled by private contract. The very nature of the rights of the parties interested in the water, and their relations to each other, and to the company supplying the water forbid any such idea. All consumers under any given system are jointly and alike interested in the water and the maintaining and operating the plant. The rates necessary to do this must be uniform. Each consumer must, if the policy of the law is carried out, bear his due proportion of this burden. The company cannot without violating the law, and its duty, discriminate between consumers. It must follow, necessarily, that special or private contracts cannot be made by the company with individual consumers which involves the fixing of different rates with different parties as the company may be able to contract with them. This would destroy

the uniformity of the rates that is absolutely necessary in order to adjust the burden equally and fairly. This being so it is expressly provided in the statute of 1885 that when fixed by the board of supervisors the rates as to *each class* of uses, "*shall be equal and uniform.*"

Stat. 1885, p. 96 sec. 5.

It must be the same, of necessity, where the rates are established by the company.

But the language of the statute of 1885 itself excludes all idea that the rates may be fixed by contract. It provides that until the rates are fixed by the board of supervisors, "*the actual rates established and collected*" by the company shall be deemed and accepted as the "*legally established rates therefor.*" This unquestionably proceeds upon the theory that uniform rates must be legally established either by the act of the company, or by the board of supervisors, and necessarily that they cannot be fixed by contract. But in this case, as we have said, the rates have never, in fact, been made the subject of contract. The company has never thought of so fixing the rates. Neither have the consumers.

But counsel again bring us back to the subject of "freehold servitudes" and insists that because the statute of 1885 authorizes the fixing of *different* rates at which water may be *sold, rented* or distributed, as the case may be, the statute necessarily "recognizes and provides for fixing rates for *freehold and leasehold servitudes.*" It is sufficient answer to this to say that the statute expressly provides for the fixing of rates

at which *water* may be sold or rented, and not for the sale or rental of "freehold and leasehold servitudes." This is a species of property, as respects the furnishing of water, that has been invented by counsel for the occasion. The separate terms, sold, rented, or distributed, were used, probably, for the sole reason that the constitution provides that water appropriated for sale, rental or distribution shall be a public use. And no doubt the terms were used in the constitution to cover the same thing by differant terms. It may be taken as certain that none of the law makers, in either case, thought of freehold and leasehold servitudes.

Counsel say "we are concerned here with those permanent irrigating rights termed easements." But this is a mistake. Their permanent right to the easement of the flow of the water is admitted. The sole question here is as to the amount of annual rental they shall pay. It is this mistake of counsel that has carried them and us into these long discussions of matters that are wholly immaterial. The mistake they make and it is most apparent, is that they assume that by acquiring this permanent right to the flow of the water they become entitled to it *at a certain and fixed rental, or rate, that can never be changed.* There can be no pretense that they contracted for any such thing. They claim, that by acquiring the water right or "freehold servitude" it follows, as matter of law, that the annual rate can never be changed. This claim is not shown to have any foundation in law or reason. Certainly there is no provision of law which supports

such a claim. Is it founded in reason? We may properly take the history of this company as conclusive evidence of the injustice of any such doctrine. When the company constructed its system and when this $3.50 rate was established, it was supposed that one main pipe line would carry all of the water and supply consumers. It was subsequently found necessary to supplement this with another pipe line known as pipe line No. 2 at an expense to the company of $68,847.97. It was also found necessary to make additions to the other main pipe line, in order to give proper service, at a cost of $49,216.25. Other additions and improvements were made costing large sums of money. The total expenditures for these additions and improvements, amounted to $229,764. 66. These not only involved a large additional outlay in construction, but the enlargement of the plant necessarily increased the cost of operation and maintenance. Besides this, as the system grows older, the necessary expenditures for repairs will largely increase. But notwithstanding all this their position is that the rate must stand the same forever and that, no matter how much the company may lose by reason of the rate being too low, it can neither apply to the board of supervisors to fix the rate, nor fix it itself, to meet the new conditions, and additional expenditures. It seems to us that the proposition is so utterly unreasonable and unwarranted that to argue it is a waste of time. The position they take that we cannot enforce the new rate because it has not been *collected*, as well as established, is, if possible still mose unreasonable. Can it be that

the language of the statute, that the rate "established and collected" shall be the rate, can, by any course of reasoning, be brought to the absurdity of declaring that the company must actually *collect* the rate from consumers before it can be regarded as *established*, and that the only thing necessary on the part of a consumer, in order to prevent paying any rate at all, is to refuse to pay the rate so established. The company, as we have seen, cannot have the rate fixed by the board of supervisors. Therefore, if its right to fix its own rate depends upon its ability to collect it from the consumers, all the consumers have to do, to prevent the fixing of any rate whatever, is to refuse to pay the rate established by the company, and refrain from applying to the board of supervisors to fix the rate, and the company's hands are effectually tied. So, if the rate already in existence is so low that it will not pay operating expenses it may be prevented from establishing a new and reasonable rate in the same effectual way. It is to such absurdities that counsel have been driven by the exigencies of their case. They are selfish enough to want this company to furnish them water, for all time to come, at a continual loss, and in order to accomplish this they have labored to convince this court that it should so construe the law, and the rights of the parties in this suit, as to deprive the constitution of all its beneficial effects in the protection of consumers of water, and to establish the doctrine that a company like this may fix its water rates by *contract*,

the very thing it was intended by the constitution to prevent.

Counsel, in conclusion, profess to grow indignant over the idea that a corporation may change its rates at pleasure. No such claim has been made. The law has furnished the consumer with an ample remedy by application to the board of supervisors if it attemps to change them improperly. And if this court should be of the opinion that it may, in the first instance, set aside or refuse to allow a rate as unreasonable, then these defendants have their remedy in this court. And in any event they have their final remedy in the courts if the board of supervisors fix an unreasonable rate. In either event they can be amply protected. On the other hand, if their contention is upheld, the company is absolutely without any remedy. It cannot apply to the board of supervisors, and if they are right, it cannot make a new rate of its own.

But their apparent indignation at a pretended wrong is misplaced and insincere. They do not and cannot claim that the $7.00 rate is unreasonable. They have not so alleged in their answer except to the extent of alleging that it is not necessary to pay operating expenses. It is only on their theory that the company is not entitled to "net revenue" that they attempt to maintain, or allege, that the rate is unreasonable.

Their pretense that they are vexed by the demand that they must enter into a contract containing the matters set forth in the answer pp. 33-35 is equally insincere. This is merely a requirement that they

make application for the water in the usual form. And this is the same form that has been in use, and has been signed by these defendants, time and again. It is a little remarkable that they should object to it just now for the first time.

As to the question of the jurisdiction of the court they say:

"On the question of jurisdiction, in respect of the amount involved we merely cite Fishback v. Western Union Tel. Co., Supreme Court Mar. 2, 1896; *and we express the hope that the jurisdiction may be maintained*, for the community and company as well, need to have the questions raised in this case settled."

We agree with counsel that it is important that the questions involved here be settled without delay. But if they are sincere in their expressed wish we are surprised that they should have challenged the jurisdiction of the court in their answer. It was wholly unnecessary.

XI.

With respect to the separate brief of Mr. Chapman his first effort is to show that the San Diego Land and Town Company is not a public or *quasi* pubic corporation dealing with a public use, but a private one dealing in water of which it is the private owner. But this, as we have shown in answer to the brief of Haines and Ward, is a contention made directly in the face of the express allegations of their answer. Besides he in effect admits that the case of Price *v.* Riverside Company, 56 Cal. 431, has settled the question against them so far as it can be settled by the court of last resort in this state. But in order to turn that case to account, in his favor he insists that while,

as held in the case cited, a corporation cannot escape its duty, as a water company, by combining the business of a private land company with its powers as a water company, in its articles of incorporation, it is equally true "one in the exercise of the powers of a purely private corporation, which acquires land acquires water rights, annexes them to the land, and sells off the land with the waters flowing upon them, cannot escape the legal effect of its deed by calling attention to the fact that in some other of its capacities it is a public corporation."

This may be conceded. But what is the legal effect of such a deed? It is specifically declared by section 552 above cited.

"Whenever any corporation organized under the laws of this state furnishes water to irrigate lands *which said corporation has sold, the right to the flow and use of said water is and shall remain a perpetual easement to the land so sold at such rates and terms as may be established by said corporation in pursuance of law.*"

Such is the legal effect of the deed of the company as declared by statute and it is an effect that the company is in no way attempting to avoid.

But as matter of fact it is not true, as a rule or as to most of the defendants, that the company had annexed the water to the land before selling the land. There may be a few cases of sales of improved land where this was done, but in nearly all cases the water was annexed to the land, for the first time, after the defendants or their grantors had become the owners thereof and by them, application to the company having been made by them for the water in the usual way. And it is upon this very ground that the other

solicitors for the defendants insist that the appropriation of the water was made by the defendants, and not by the company, because they, the defendants, and not the company applied the water to a useful purpose which was necessary to constitute an appropriation. Besides it is not alleged in the answer, or pretended in the argument, that the water was appropriated for the use of the company, or its stockholders, alone, as was the case in the McFarland case. The water was appropriated for sale, rental, and distribution, according to the specific allegations of their answer, and according to the facts, and not for private use. And as evidence of this fact water has, according to their answer, been furnished to two hundred and fifty-six acres more land owned by others than to lands purchased from the company, besides all of the water that has been furnished to National City and its inhabitants.

And it must be remembered in this connection that the defendants, in their answer, expressly aver that they are entitled to this water right and admit *that* they are liable to pay an annual rental, which could not be so if this company were dealing in water owned by it in private right. The allegation is:

"These defendants admit that each defendant has become the owner *of a water right* to a part of the waters *appropriated and stored by said company*, necessary to irrigate his tract of land, *and that each defendant is liable to pay for the use of said water a yearly rental, such as said company is entitled to charge and collect.*',

Ans. p. 8, line 27.

They go further and allege that they are also entitled to water for domestic use, and that their

"water right embraces the right and easement of the service of the reservoir and distributing system of said corporation for the delivery of the water at and upon their respective lands."

In short they aver their right to everything to which they would be entitled, if it were such a corporation as they insist it is not, viz. a *quasi* public corporation dealing in the water, under the constitution, as a public use.

Their idea that they have become part owners of the company's plant by way of "freehold servitudes," as well as their claim that the company is a private one, and not subject to the constitution, seem to have been conceived even after they filed their answer. There seems to be nothing new in the argument in this brief on this question and to answer it further would be only to repeat, in substance, what has already been said in reply to the other brief.

XII.

With respect to what is said in point IV of this brief in regard to deeds made since December, 1892, in which the company expressly sold and conveyed water rights the learned solicitor is mistaken in his statement that it is upon the promise in this deed, to pay an annual water rental that our argument is built. We do not understand that this express promise to pay an annual rate affects the legal *status* or liability of the parties in the least. By section 552, when the company which had appropriated the water, sold the land under its system, the water right passed with the land *subject to the payment of the annual rental.* The

section so provides in express terms. Therefore the promise to pay this annual rental became a part of the contract by operation of law, and was just as binding as if so stated. So, where the water was put upon the land voluntarily, and without compensation. But when the company came to sell this water right and charge a consideration for it, the terms upon which it was sold were set out in the conveyance, and very properly so. What we did say, with respect to these contracts, in substance, was that the defendants were claiming their rights under contracts made with the company which precluded it from charging an annual rental, but that the only *contracts* alleged in the answer as having been made with the company, were the ones above mentioned, and that they did not confine the rate to $3.50 per acre per annum but left the rate to be fixed by the company in pursuance of, or as prescribed by law, as it necessarily must be in all cases. It was only to this extent that our argument was built upon these contracts. It was intended to show that the only contracts made by the company had no such effect as they claimed for them.

Of course it would be absurd, as counsel say, to construe such a contract to authorize the company to charge any price for the water it pleased. Such contracts,authorizing the company to fix the rates,whether expressed in the contract or incorporated into it by operation of law, must, by implication of law, be limited to the fixing of reasonable rates. And if the rates established are unreasonable the consumer may have the rate abrogated and a new one fixed by the

board of supervisors. It is proof evident that the rate established by the company, in this case, is not unreasonable, that the defendants would have applied to the board of supervisors, where they could have the question settled before this case could be put at issue.

But, if it is absurd to claim that such a contract gave the company the right to establish any rate it pleases is it not more absurd to say that the contract actually fixes the rate at $3.50 per acre when that sum is not even mentioned in the contract? The trouble is that in order to make their case appear stronger, the necessity of which we concede, counsel will persist in attributing to us claims that we have never made or even hinted at, and this is one among the many. We have never claimed that the company can fix any rate it pleases. And the calamities that might result, if the company should be accorded the power to fix the rates, as depicted by counsel, are soul harrowing in the extreme, but fortunately they are purely imaginary and we can, with perfect safety, assure counsel that they will never happen. There is nothing in the conduct of this company to warrant any such assumption. The company fully realizes that it cannot charge such a rate as will discourage the planting and improvement ment of property under its system, which would be more disastrous to it than to any of the defendants. The company believes, and we believe, after the most careful consideration of the subject, that, at the rate of $7.00 per acre per annum it cannot make one dollar for its stockholders out of the sale of water. That

amount it hopes will just about save it from actual loss, growing out of the operation and maintenance of the plant, and its depreciation. And it believes, and we believe, that this sum can be met by the consumers without distressing them. At the time the $3.50 rate was fixed the lands of the defendants were in a wild state and unimproved. They must wait several years before receiving any returns from their trees. Now, in the case of most of them, their trees are in bearing and they can pay the rate fixed without any injustice to them. On the other hand, to compel the company to continue to furnish water at the old rate, will be absolutely ruinous. Under these circumstances their dire predictions of future disaster is, to use their own language, "moon shine."

And the insinuation of counsel that his associate solicitors, and other of his clients, are "unsophisticated grangers," whose minds would dwell upon and advert to advertising circulars of the company announcing that water would be furnished at $3.50 an acre is unfounded. One who could write such a brief as the one presented by his associates in this case may be a visionary but he cannot be classed with the unsophisticated. And we rise in the defense of his other clients to say that a more intelligent and well informed community cannot be found anywhere. The only thing that we know of against them is that they are not willing to pay reasonable water rates. And if any of these defendants have relied upon an advertising circular, if there ever was one of the kind counsel intimates, they possess much less intelligence than we give them credit

for. And the attempt to make these imaginary advertising representations a part of a written contract in order to vary the meaning of plain terms shows the extremity to which counsel are driven. That the company should have charged for a water right and then assumed to raise the annual rates is made another ground for complaint. But while we do not understand why this should not be done this complaint rests upon a very slender foundation. As a matter of fact water rights have been sold for only two hundred and twenty acres and some of the defendants who bought these rights have expressed their willingness to pay the new rate and asked to have the suit dismissed as to them which has been done. As compared with the defendants who have had the right to the perpetual flow of the water attached to their land for nothing these interests are as nothing. Under all the circumstances it will be better to stick to the plain law rather than attempt to swerve from it on the plea of hardships assumed to exist and so ill founded.

The classification of different consumers, as made by the company, has been referred to in both briefs, as if it had some bearing on the question involved here. All of the defendants fall under the first class which includes persons who have acquired water rights. The other class covers those who have not acquired water rights, and these are required to pay an additional amount, equal to six per cent. interest on what the company had fixed as the value of the water right and which those of the first class had paid, or secured without paying for it.

There is no complication in these contracts as counsel assume. In many instances the company furnishes water for temporary purposes, contracting that such use shall not give the party a water right. These temporary takers, and it may be others, who have not acquired a water right are, under the classification, required to pay an additional amount, which is made uniform, and is intended to put them on an equal basis with those who have paid for the water right. This is done by charging them interest on the amount that has been paid by the other class and not by them. This was done, as we now remember it, to accommodate some water takers in National City who preferred to take water in that way rather than pay for the water right.

XIII.

The question whether the bill shows the danger of a multiplicity of actions, sufficiently to give this court jurisdiction, is raised and discussed at considerable length. In this discussion it is assumed that the allegation that a multiplicity of suits are threatened is the only ground of jurisdiction. But this is not true. Irrespective of the ground of multiplicity of suits the question of the right to establish and charge water rates and the reasonableness of such rates are matters of equitable cognizance and, the parties being citizens of different states, of federal jurisdiction.

But if this were not so, if the dangers of a multiplicity of suits is a sufficient ground of jurisdiction in any case, and this is not disputed, there could be no clearer, or stronger, case than this. In the classes of

cases of multiplicity of suits which will give jurisdiction, as set out in Pomeroy's Equity, and copied in the brief on the other side, is the following:

"Where the same party has, or claims to have, some common right against a number of persons, the establishment of which, regularly, requires a separate action brought by him against each of those persons, or brought by each of them against him, and instead thereof he may procure the whole to be determined in one suit brought by himself against all the adverse claimants as codefendants."

Counsel say this is the class, if any, under which this suit may be maintained. And certainly it covers this case exactly. The defendants here number over two hundred, we believe. One remedy of the complainant was to shut off the water from the premises of each of the defendants if they refused to pay the established rate. The other was to sue each one of them for the amount of his water bill. If it had pursued the former remedy each of the defendants could have brought separate actions for a mandamus to compel it to turn on the water. In the latter the company would have been compelled to bring a separate suit against each water consumer. In neither case would an adjudication have been binding upon any other water consumer. Consequently, unless some one should have been willing to submit, without being compelled to do so over two hundred actions at law would have been necessary to settle a question that can be better settled by this court in one suit. The expense that would have accrued and the annoyance of such litigation in the community could hardly be overestimated.

But it is claimed that, aside from the allegation of a threatened multiplicity of suits, the bill contains no

cause of action. If so counsel could much more conveniently have raised the question by demurer to the bill. But we hardly think this point is seriously made. Here are the very important questions: 1. Whether the company has the power to change its annual rates of charges for water. 2. Whether the rates established are reasonable. The last issue is raised, or attempted to be raised, by the defendants in their answer. If they are right that the question can be determined by this court, in the first instance, there must be a decree upon the issue as to the reasonableness of the rates. And in either event the court is called upon to determine whether the defendants have this right or not.

As to the question of the power of the company to change the rate it involves necessarily an adjudication of its right to collect it. Such an adjudication would cover exactly what would be litigated in the two hundred and more actions brought to collect the rates, and would bind all parties upon the issue of the right to collect them. So as to the separate mandamus proceedings to compel the turning on of the water.

Again it is claimed that the cause of action here is not common to all of the defendants because they claim under different contracts. But the difference in the contracts in no way affects the question of the right of the company to establish and collect the annual rate. The defendants make common cause against us and aver in their answer that we have placed them all on the same footing as to the annual

rates and therefore the defense made by one may *be* made by all.

Ans. pp. 16-18.

They allege that they are all the owners of water rights and that for that reason they can not be required to pay this rate.

Ans. pp. 8-9.

The fact that none of the defendants make any defense, special to themselves, is amply sufficient to show that the cause of action is common to them all, if there were any question about it.

XIV.

With respect to the effect of section 552, counsel takes the singular position that where water is made appurtenant to particular land, it ceases to be a public use, and that therefore the section referred to was not intended to deal with water appropriated as a public use. Such a doctrine would revolutionize the water laws of this state. According to that view, so long as the right to use the water is floating around loose, and unattached to any land, it is a public use, but whenever any land owner is fortunate enough to corral it on his land it passes out of the control of the constitution and laws and becomes a private use. And in order to constitute a public use in water, and continue it as such, it must be open to a scramble on the part of the whole public, and no part of it can ever be made appurtenant to land. Well, we must confess that to us this is a most startling proposition. Counsel who write the other brief

earnestly maintain that the water is never appropriated at all until it is actually applied to the land. Therefore it cannot become a public use under the constitution because it is only water *appropriated* for sale, etc., that is made a public use. They further maintain, that, by getting the water on his lands, that is to say, by appropriating it, the land owner becomes entitled to its use, perpetually; that it becomes appurtenant to his land. The other counsel says that whenever it becomes appurtenant to the land, that is to say, when it is appropriated it ceases to become a public use. Thus, under the constitution appropriating the water makes it a public use and according to counsel the same act converts it from a public to a private use. It is plain to be seen, now, why these learned solicitors wrote separate briefs. They do not seem to be able to get themselves together. And the reasoning of one destroys that of the other whenever they get onto the same subject. The results of their combined reasoning, if followed to conclusions, would certainly produce startling results.

It is further claimed that the statute cannot apply where there has been an actual contract. This we do not concede. The rates are matters not subject to private contracts, as we have shown in reply to the other brief. But if this were not true no contracts were made in this case. We are called upon to make this statement again and again because counsel constantly *assume* that such contracts were made. But we have now learned, for the first time, on what they base this assumption. It is said in this brief that the statute of

1885 requires, in order that the rates fixed by the company shall become operative that the company shall not only *establish* the rates but it must also *collect* them, and when the consumers permit them to be collected they thereby *consent* to them; the minds of the parties have met, and the rates are thereby fixed *by contract.* We cannot but admire the ingenuity of this argument, but it can hardly be looked upon as convincing. As we have said before, if it is a contract it must be binding on both parties and neither could, by their voluntary act, abrogate or set it aside. But even the learned solicitors on the other side will not contend, for one moment, that, notwithstanding the establishment of the rates in this manner, the consumers might not, the very next day, apply to the board of supervisors and have them abrogated and new ones established. And the statute, itself, expressly provides for the fixing of the rates, more than once, by the company; before they are established by the board of supervisors, and after that body has abrogated its own rates.

Stat. 1885 p. 97, Sec. 5.

So if the consumers are not satisfied with their first "contract" they can have the board of supervisors abrogate it. After the board has established the rates they can be asked to abrogate them, and if they do so, the company must make a new "contract" with the consumers by establishing the rates and *collecting* them. And if the consumers refuse to pay the rates as they are doing now, of course the contract cannot be made. Their voluntary consent is necessary to

make a valid contract, according to their reasoning. It follows, that in that case, the company could never collect any rates, for the reason that by the terms of the constitution it can only exercise its franchise of collecting rates *as prescribed by law* and the only two ways prescribed are through uniform rates established either by the company or by the board of supervisors. The position of counsel, when followed out to its logical and necessary results, not only makes the statute of 1885 unconstitutional, but renders it so absurd as to be positively ridiculous. There can be no doubt that the use of the words "establish" and "collect" were used to cover the same thing by the rates the company may put in force. And the necessity of changing and re-establishing the rates is recognized by the statute when fixed by the board of supervisors, and provision is made for such change. The same necessity must exist in case the rates are established by the company. It was not expressly provided for because it is always open to the company, subject to the restraints provided by law, which have existed since the statute of 1862.

Beside the necessity for the change of such rates, mentioned heretofore, growing out of increased expenditures for the public good and convenience, there is every reason why a corporation might, for the encouragement of improvements, submit to the loss growing out of low rates, while orchards are in planting, and early growth, where the land owner is receiving no returns, and later on, when the orchards are productive expect, and demand, a more remunerative rate.

And this is precisely the condition of things here. And yet counsel declare that a law that would allow a company to change its rates, subject at all times, if it fixes an unreasonable rate, to the action of the board of supervisors, would be "monstrous and unreasonable." We confess our inability to see the monstrosity, or unreasonableness, of such a law even after reading the able, plausable, and persuasive argument of the learned solicitor, who characterizes it as such. But we are pleased to see that he points out specifically in what respect the statute, so construed, is unreasonable and monstrous. It is because it requires, in order to bring about action by the board of supervisors, that 25 citizens and tax payers shall petition therefor, and he seems to fear that the necessary number, willing to petition, could not be found. This is simply getting back to what has been the chief stock in trade of both of the defendants' briefs viz: imaginary hardships and difficulties. But it would hardly be a difficult matter, if a whole community of people were being oppressed by high rates, to secure 25 petitioners for relief. And certainly it would not be, in this case, where over 200 defendants have employed numerous and able counsel to enter upon a long and expensive litigation for their claimed rights, and where their rights, if they are being invaded, could be protected by a most simple, inexpensive and speedy proceeding before the board of supervisors.

But the secret of it is disclosed in the brief of the other solicitors. It is not because they cannot muster sufficient force to appeal to the board of supervisors,

but because they do not want to. They protest, earnestly, that it would be monstrous to compel them to resort to the remedy that the law has provided for them. The hardship they fear is that justice may be done them. If the fear of the other learned solicitor, that 25 citizens could not be found to act, in any case, which is not likely if there should be good ground for it, is realized, the legislature might properly be asked to amend the law, but this court cannot misconstrue its plain provisions to give relief when no relief is needed. But counsel very inconsistently insists, after contending that 200 and more consumers cannot raise the necessary 25, that *one* consumer, the company, as a land owner, may do so. But the company is not complaining of the rates established, therefore it has no cause to petition. The argument is exceedingly far fetched.

But counsel claims that it is absurd to say that it was intended by the constitution that rates which must be established, as prescribed by law, should be established by the mere act of the company itself. This power, on the part of the company to fix the rates, was not, at the time the constitution was adopted, absolute or unlimited, nor has it ever been since. Under the statute of 1862, as we have shown, it was subject to the action of the board of supervisors, and has been so ever since, and is so now. But we can see no reason why the constitution should not have contemplated, that until action should be taken by the board, rates established by the company should prevail. Certainly the law making power has so con-

strued it, and prescribed that as one of the modes of establishing the rates, and that construction has stood unchallenged, so far as we know, for over ten years. The force of this point, as against the statute as it stands, which is perfectly reasonable and just, not appearing to be sufficiently strong, he proceeds to conjecture what the legislature might do by giving the company unlimited and unconditional power to establish the rates. But it is sufficient to say that the legislature has, as yet, done nothing of the kind, and it is reasonably certain that it never will. If it does it will be time enough then to question its power.

The point made, that the constitution should receive a practical and common sense construction is well taken. We have no right to ask anything else. But we think this test will effectually set aside counsel's construction of this article of the constitution. And we submit that the statute of 1885 is in strict conformity to its provisions.

But the inconsistency of this position, as compared with others taken by them is quite apparent. They contend, in this connection, that the company has no power to establish the rates. In other parts of their brief they insist with great earnestness and apparent sincerity that the company *has*, since the constitution took effect established the rates, that the defendants have acquiesced in them, and that all parties are absolutely bound by them even to the exclusion of the right of the municipal authorities to interfere. When the company establishes rates that suit the defendants, the power exists, but when it proposes to fix

rates not satisfactory to them it cannot do so, because the rates must be fixed by the municipal authorities, and a law that permits them to be established by the company is in violation of the constitution because the fixing of rates is a "municipal function." These gentlemen should keep to the right, and not run into each other in this way. We find it exceedingly difficult to follow them in their meanderings. They cross each others tracks at every turn and their turnings are numerous. But even in this brief the old complaint, that to compel them to apply to the board of supervisors, and then, if the rates are not satisfactory, to the courts for redress, is too great a hardship, is reiterated. It ought to be sufficient answer to this to say that this is the remedy given them by law, and that the court cannot give them a different one, because this one may not be quite satisfactory in the present case. But in order to prove the hardship they assume that the board of supervisors will fix an unreasonably high rate, and thereby compel them to appeal to the courts. They may so assume, in argument, if they have nothing better, but the court can entertain no such presumption.

The case of McCreery *v.* Beaudry, 67 Cal. 120, cited by counsel, seems to have no particular bearing, except that it holds just what we are attempting to maintain here, viz., that "each" member of the community "*by paying the rate fixed for supplying it*, has a right to use a reasonable quantity of water in a reasonable way." And it is equally true that "water appropriated for distribution and sale is *ipso facto* a public use,

which is inconsistent with the right of the person so appropriating it to exercise the same control over it that he might have exercised if he had never so appropriated it." The decision is directly in line with our contention, and diametrically opposed to theirs, to the effect that the company appropriating the water may contract and deal with it as if it were its own private property.

XV.

But the learned solicitor next effectually knocks the props from under the argument of his associates by his declaration:

"It is *not our claim* that the company *is estopped to change the rate by reason of the fact that it has established and collected a lower* rate; but we claim that in so far as the company is engaged in furnishing water *for public use, it has no right to make rates at all, either in the first instance* or by way of changing them after they have once been adopted; that in so far as the use is private, and the right arises out of a contract, or deed, the rate fixed by the contract controls, and the rights vested by the deed, at the time it is made, cannot be changed by one party to it."

This leads back to the original controversy as to the nature of the use in the water, whether public or private. We submit that their answer avers the use, in this case, to be public, and that we have clearly demonstrated it to be so, in the earlier pages of this brief. This being so it is broadly admitted that the company is *not estopped by establishing and collecting the $3.50 per acre rate to change and increase the rate.* This is just what we have been laboring to prove, and the contrary, if we have not misunderstood their brief, throughout, is the bulwark of their defense, as maintained by his associate solicitors. With this admission the question becomes a very simple one. Does the statute, in the

absence of action on the part of the board of supervisors, authorize the company to establish and change its own rate, until such action is taken, and if so is this provision of the statute constitutional? That the statute authorizes this mode of establishing the rates, in clear and unambiguous terms, there can be no question. There is no intimation anywhere that the consent of consumers or their acquiescence therein is necessary to the establishment of the rates. But they say such mode cannot, legally, be authorized, because the rates must, by virtue of the constitution, be fixed as "prescribed by law." The answer is that this *is* the manner prescribed by law. And we see no reason why the legislature might not prescribe that, until the consumer should ask the board of supervisors to fix the rate, the same might be fixed by the company, the rates so fixed to be subject to action by the board, abrogating the same. There is nothing inimical to the constitution in this, that we can see, and it seems to us to be entirely just and reasonable. If the consumer is not satisfied, his remedy, by petition to the board, is open to him.

Counsels' position is further stated thus:

"In short we claim that nothing in the constitution, or the laws, forbids parties from dealing with each other in respect to *water rights* in such way as to establish the rights of both parties, by contract, but that where the use is left, by the contract, *one which is a public use*, or a right that belongs to the rest of the public, that then the power to regulate and control belongs to the state; and when the statute has said that rates, as fixed in a certain manner, shall obtain until the public authorities themselves act, or after their action has been abrogated, *this does not mean that the rates become forever fixed by the contract and beyond the state control.*"

Brief p. 28.

This is precisely our contention, most admirably and clearly stated. We are obliged to counsel for this material strengthening of our feeble efforts to meet the arguments of his associates. The matter of "water rights," as he says, is matter of contract and one consumer may obtain a preferred right to the perpetual flow of the water, where there is not enough to supply all the lands under the system. But the use of the water is none the less a public use and under the control of the state because he has contracted for this preferred right. The collection of the rates, by the company, for furnishing the water, is a "franchise" and can only "be exercised by authority of, and as prescribed by law." Therefore, as counsel says, the rates can only be established as the law prescribes, and, if fixed by the company cannot be binding forever. But unfortunately his associate counsel contend that they *are* binding forever. We feel assured, however, that with his assistance we have sufficiently shown the fallacy of that reasoning.

Counsel closes by saying:

"As to the argument in the brief, based upon the supposed reasonableness of the charge of $7.00 an acre, with all of the collateral facts that are of importance, in that calculation, I leave to my associates."

The other solicitors have not *said* we leave this task to associate counsel, but in fact they *have* left it to him, and both of them have left it to the court. But, as there is nothing in the answer to show that the rate is unreasonable, it will not be a difficult undertaking.

We were to have been favored with another brief,

by still another of the solicitors, and extended him additional time, by stipulation, but the time has long since expired and the brief is not in. Perhaps this branch of the subject was left to him. If so the effort to prove the rate to be unreasonable has evidently been too much for him and he has fallen by the wayside.

But we submit, that there is no issue raised by the answer as to the reasonableness of the rates, except upon the bases of their claim that they are not bound to pay any "net profits."

In conclusion we must enter an apoligy for the length of ~~their~~ this brief. Our excuse is, in part, that the solicitors for the defendants have led us into the discussion of mere abstract questions, not material to the case, as we believe, but which we do not feel it proper to ignore, and in part that the questions involved are exceedingly important and deserve the most careful and thorough consideration by counsel, and by the court.

Respetfully Submitted,

WORKS & WORKS,

Solicitors for Complainant.

J. S. Chapman.

No. 671.

IN THE

CIRCUIT COURT OF THE UNITED STATES,

NINTH CIRCUIT,

SOUTHERN DISTRICT OF CALIFORNIA.

CHARLES D. LANNING, Receiver, Etc.,

Complainant,

vs.

H. C. OSBORN, Et Al.,

Defendants.

Defendants' Brief on Exception to Answer.

WARD & HAINES,
Of Counsel for Defendants.

No.....

IN THE

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OF THE

UNITED STATES,

NINTH CIRCUIT, SOUTHERN DISTRICT OF CALIFORNIA.

CHARLES D. LANNING, Receiver, Etc.,
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vs.

H. C. OSBORN, ET AL.,
Defendants.

DEFENDANTS' BRIEF ON EXCEPTION TO ANSWER.

It is the avowed purpose of the solicitors for complainant, to raise upon the exceptions to the answer, virtually all the questions of law in the case.

The effort has been to make the answer conform as closely as may be to the facts; and the decision upon the exceptions will be largely and perhaps wholly decisive of the cause.

It is sufficient merely to advert to the rules governing exceptions of this character as laid down in Daniel's Ch. Prac. (Perkins' Ed.).

1. "The Court, in cases of impertinence, ought be-
"fore expunging the matter alleged to be impertinent,

" to be especially clear, that it is such as ought to be " struck out of the record, for the reason that the error " on one side is irremediable, on the other not." Pages 769, 359 note.

2. " An exception for impertinence must be sup- " ported *in toto*, or it will fail altogether." Ibid, p. 769.

3. " If the matter of an answer is relevant, that is, " if it can have any influence whatever in the decision " of the suit in reference to any point to be considered " in it, it is not impertinent." Ibid, 769 citing.

Tucker vs. *Cheshire R. R. Co.*, 1 Foster (N. H.) 38, 39.
Van Rensselaer vs. *Bruce*, 4 Paige, 177.
Hawley vs. *Wolverton*, 5 Paige, 522.

I.

These rules and especially the second seem to show that the exception " First " numbering 47 paragraphs and the exception " Seventh " cannot be supported.

II.

The exception " Second " is a pure misapprehension of the theory upon which one class of the defendants have pleaded the purchase from the company of lands with the appurtenant easements in its diverting and distributing system; and upon which another class of defendants, not purchasers of land from the company, have bought easements under the form of contract set forth on pages 17 and 18 of the bill.

They have not pleaded the facts in this connection, to show return to the company of " a part of its princi- " pal invested in its said water works and *that therefore* " *they should not be required to pay rates upon a basis of* " *allowing to said company any interest on the amount so* " *advanced or returned to it*," as assumed by the exception.

Neither of them can fairly be accused of having had the fatuous intention to contribute the money so paid, be it much or little, for the general relief of all who had come, and all who might come under the system equally with himself, from the obligation to pay interest "on the amount so advanced or returned to it." Purchasers of land under irrigation from the company might as well be accused of having paid the large prices of from $300 to $500 per acre, in order to make the prices of land lower to all who might buy afterwards. Whether servitudes upon the diverting and distributing works can be so sold and made appurtenant, is a most important question in this case, which we shall consider further on.

But we ask absolution from the charge that the prices paid for such attempted purchases, were intended to be contributed to the whole community.

III.

It will be convenient to consider exceptions "Third," "Fourth," "Fifth" and "Sixth" after a general consideration of the exceptions grouped in the "First".

IV.

However defective in form the "First" exception may be, it suggests questions of fundamental importance to the irrigation interests of this State. And it is not too much to say, that the growth of the community whose natural, most convenient, and, at present, only water supply, is under the control of the complainant receiver, is at a stand-still, until a proper solution of these questions is judicially given. And the same is

true of the San Diego Land & Town Company itself, since it is the largest land owner and dealer in land, under the system.

Since this corporation is now being administered through a receiver, there is a peculiar, and no light responsibility thrown upon the Court, in calling upon it to settle the legal principles which should govern the corporation in the relation of the lands it has sold and has to sell, to the water supply for irrigation which it administers; and also, the principles which govern the relation of the water supply to other lands, already supplied by it with water and those which may demand water.

A most striking phase of the superficial aspect of the controversy is the extreme anxiety of the corporation (for the receiver is an officer of the corporation and entirely identified with its plans and purposes) to get away from its contracts and take shelter under the Constitution and statute of 1885; and a corresponding dread on the part of the consumers to admit that they have come in respect of the water supply, under absolute public regulation, as the corporation contends. Thus there is a reversal of what one would suppose to be the natural order of things. It has been supposed that Art. 14 of the Constitution was adopted, and, that the statutes pursuant to it were enacted, for the protection of the individual consumer; but we have the remarkable spectacle, of seeing him flee from his supposed defences; and, of the corporation pressing hotly in to occupy them.

The corporation says, "we are content to be circumscribed by the Constitution and the laws; let them

" be the only breath to our nostrils, the only mode of " our existence, the sole galvanizer of our functions."

It declares that it has no capacity to bind itself by contract; " the Constitution and law," it says, " manage " the the whole thing excellently well, to our liking."

The consumer says, "for Heaven's sake, leave us " some autonomy; do not compel us to commit all " power to the board of supervisors to fix the value of " our property and the terms on which we shall enjoy " it. Let us have such protection as we can get by our " contracts, fairly made, and honestly kept."

" Not so," says the corporation. "Go you to the board " of supervisors. You shall be driven to the board; " for the statute gives us the power to raise the rates " without limit; your only resource is to the board, " and not to the courts; and we have doubled the rates " on you to drive you to the board. We are content " with net revenue anywhere between 6 and 18 per " cent., which the board must allow, based on such evi- " dence as we control, after payment of such expenses " as we have the making of, not omitting salaries. Get " you hence to the board."

Is not this the naked plot of the comedy now on rehearsal before the Court?

What else means the assertion for complainant, that the Constitution and statute law have taken away from corporations and consumers all power and capacity to fix or regulate their relations by contract; that the statute vests in the corporation the power to raise rates whenever it pleases; which asserts in the language of the fifth exception, " that the *defendants have no stand-* " *ing in the Court to contest the reasonableness of said* " *rates, but their remedy, if any they have, is to apply to* " *the Board of Supervisors of the county in which their* " *land is situated to fix and establish rates.*"

We do not deprecate the putting of limitations on the public control, where the consumer resorts to it.

But to compel him to accept such control, unlimited by his supposed contract rights, under the duress of a water famine deliberately caused by complainant, as boldly avowed in his bill, is another thing altogether.

It is not out of place to advert to more general considerations which mark whither we are tending. San Diego county is but an illustration of what is going on in the whole of Southern California. Numberless water corporations have in some form or other seized upon every reservoir site, and are scrambling over each other for control of every stream and rivulet in the county. The posting and recording of notices of appropriation of water is a regular and unremitting industry, in anticipation of the time when works can be constructed, or profitable sales made to other corporations, private or public.

The control of the whole water supply is surely gravitating into the hands of the corporations, and necessarily so; and under the application of proper principles, beneficently so; for consumers of water, cannot, each for himself, divert the water and construct water works.

But if it be established—if it could be established—as the other side now contends, that no land owner can acquire and protect interests in the water system by contracts with such corporations; that the whole matter of net revenue (as distinguished from the expenses of maintenance and operation) must remain an annually recurring question, which may be precipitated at pleasure by the corporation by raising the rates; that the only refuge of the consumer is to the board of supervisors; and that it is against their decision alone that he

may appeal to the courts; if that be true, then the consumer is in an infinitely worse plight than he was before the Art. XIV was adopted.

For if it be the law that no person can protect himself by contract in relation to supplying himself with water; that, on his part, it is all left to the board of supervisors; then that body is vested with a power that is absolutely startling. Let all the corporations that control the whole water supply, concentrate their attention upon the fact—if it can be established to be the fact—that the board has delegated to it, this power; that the corporation can call this power into exercise at its pleasure (though the right so to do is, in form, denied to it by statute) by the simple means pursued here, as set forth in the bill; and we need no prophecy to foretell the result. The office of supervisor will be, in the pecuniary sense, a valuable, as well as a powerful one. The greater element of the value of every irrigated tract will be constantly in the state of flux, practically at the mercy of the company on the one side, and of the board on the other, subject to frequent costly appeals to the courts; it will also perforce be in politics, and subject to the vicissitudes of political manipulation, with the most tremendous odds in favor of the corporations; for they will have nothing to lose, in view of the net guaranty by the public power of a safe minimum rate of interest, and everything up to 18 per cent. above that to gain.

The whole scheme as here urged, is virtually to extend the power of taxation in a new and subtle form; to lead up to fuller demonstration of Marshall's declaration, that "the power to tax is the power to destroy."

It is putting in practice the political philosophy of absolute government, without the administrative safeguards of which that form admits, and ours does not. It is the worst form of paternalism, coming home directly to every acre, taking the business of the people out of their own hands and vesting it in officials. The attempt made in this case, is a concrete illustration of the socialistic dream of all people managing each body's business, sought to be forced upon the individual for the advantage of a corporation, as literally an *imperium in imperio*. We have made these observations to emphasize the expression of the great importance of the questions actually before the Court.

V.

Its "Articles of Association" show that the corporation was organized among other purposes for "the "construction and maintenance of dams and canals for "the purpose of water works, irrigation or manufactur- "ing purposes; for the purchase and sale of real estate "for the benefit of its members; the purchase, location "and laying out of town sites and the sale and convey- "ance of the same in lots or subdivisions or otherwise; "the promotion of immigration; the encouragement of "agriculture and horticulture," as well as "the supply "of water for the public." (Answer p. 3)

The answer avers that the corporation is an appropriator of water under the statutes of California and the Acts of Congress, of the water of Sweetwater river, both for sale, rental and distribution, and for the irrigation of its own lands, while it shall continue to own them and after it has disposed of them, and for enabling the corporation to sell and dispose of its lands as irrigated lands, and to supply the needs of the people who

should purchase its lands and settle on them (pp. 3-4).

It thus appears that the water diverted and led by the company's works was such as was open to appropriation, and therefore so far forth, water flowing from the public lands of the State and the United States.

And in this connection is a fact overlooked in drafting the answer, that the San Diego Land & Town Company is the grantee of all the riparian water rights in the Sweetwater river for the National Ranch, under a grant reaching back by *mesne* conveyances to 1869. The Sweetwater river has its mouth in the National Ranch on San Diego Bay, and enters the ranch some distance above the breast-work of the dam, and some seven miles above its mouth.

For a history of these riparian water rights see *Doyle* vs. *San Diego Land & Town Co.*, 46 Fed. Rep., 709, a case in this Court. The corporation was also in 1887 a large riparian owner on the Sweetwater river, and so far as it has not sold its lands, still remains such owner.

It would seem that under these facts (as to which, so far as material and not already pleaded, leave will be asked to perfect the answer) the corporation, so far as the water supply was brought upon its own lands became the owner of both land and water in one estate. It built its dam and pipe system as set forth in the answer, and threaded its own land with a net-work of pipes filled with water. So long as there was and is no severance of title to any of its land, it seems clear that the company had and has no relation to its water supply derived from appropriation for use on its own lands and from the grant to it of riparian rights, which was or is

subject to public regulation—unless it was and is, the apportionment of the cost of the maintenance and operation of its works as between it and outside land owners using the system; there was and is no occasion, and no room, to fix by public authority an annual rate of *net revenue*, which it should pay to itself for use of its own water works.

McFadden vs. *Board of Supervisors*, 74 Cal., 571.

When it sold and conveyed parcels of its lands to certain of these defendants, unless the grants contained an express reservation of that portion of the corporeal estate which consisted of the water supply led upon the land, such supply passed with the land. Upon familiar principles, so much of the pipes as lay within the boundaries of the granted land, passed with the fee and in fee; and as to the reservoir and so much of the conduit as led up to and lay outside the boundary of such land, upon the severance, there sprang up a relation of servient estate to the land granted, as the dominant estate; in other words, the servitude upon the water system, so far as such system was not actually within the land granted, passed by the grant as an appurtenant easement; and it passed without express mention, and even without the use of the term "appurtenant" in the deed.

Cave vs. *Crafts*, 53 Cal., 135.
Farmer vs. *Ukiah Water Co.*, 56 Cal., 11.
Fitzell vs. *Leaky*, 72 Cal., 477.
Standart vs. *Round Valley Water Co.*, 77 Cal., 399.
Coonradt vs. *Hill*, 79 Cal., 587.

McShane vs. *Carter*, 80 Cal., 310.
Crooker vs. *Benton*, 95 Cal., 365.
Clyne vs. *Beneeia Water Co.*, 100 Cal., 310, 314.
Tucker vs. *Jones*, (Mont.) 19 Pac. Rep., 571.
Sweetland vs. *Olsen*, (Mont.) 27 Pac. Rep., 339.
Taylor vs. *Nostrand*, 31 N. E., 245, 246.
Simmons vs. *Winters*, (Or.) 27 Pac. Rep., 8, 10.
Hindman vs. *Rizor*, (Or.) 27 Pac. Rep., 13.

"No one can acquire an easement in his own estate. "But in the absence of an express grant of such right "from another, an easement in water may arise; first, "by prescription; second, upon severance of tene- "ment."

Gould on Waters, Sec. 327.
Wash. on Easements and Serv., (3 ed.) p. 25.

But it is also laid down that, "the interest of an ease- "ment may be a freehold or a chattel (leasehold) one, "according to its duration." Wash. E. & S., p. 6.

Are the easements of the defendants who are grantees of the company, freehold or leasehold?

Sec. 519 of Gould on Waters lays down the rule: "A "conveyance of water rights should be construed in "the light of preliminary agreements and circum- "stances rendering the purpose of the parties plain," citing:

Woodcock vs. *Estey*, 43 Vt., 515.
Jennison vs. *Walker*, 11 Gray, 423.

Under all the circumstances set forth in the answer, especially the payment of the prices for the land as irrigated land, and that for more than five years the company has treated such lands on the same footing, as to rates, as its own, we do not hesitate to say, that the grants of the appurtenant easements, are freehold. And

this accords with the perpetual easement declared under such circumstances by Sec. 552, Civil Code.

This also accords with the unqualified averment in the bill, that each such defendants have, "by purchase "become the *owner* of a water right to a part of the "water appropriated and stored by said company, ne- "cessary to irrigate his tract of land;" it also accords with the like explicit admissions and assertions in the answer.

"It is in the nature of servitude not to constrain "any one to do, but to suffer something, *ut aliquid pa- "tiatur aut non faciat.*" Wash. E. & S., p. 5.

Yet, "In case of servitude, the *jus in rem* may hap- "pen to be combined with the *jus in personam* against "the owner; and so may happen to be combined with "a right to an act against the owner—*e. g.*, a right to "have a way repaired by the owner." Austin's Jurisprudence, Sec. 1071.

The personal duty of the corporation after having granted the servitudes in its system as appurtenant easements to land sold by it, is to manage, maintain and operate its system. For the source of this obligation, we may, in all branches of this case, look to the clause in its corporate franchise investing it with the power, and therefore the duty, of the "maintenance "of dams and canals for the purpose of water works, "irrigation, etc.," and the general incidental powers recited at the close of the extract from its articles set forth in the answer (p. 3). This is also consistent with its contract to continue the "duty" of the system; and with its duty to serve the beneficial use so long as it diverts water dedicated by the Constitution and principles underlying law of appropriation, to the public use.

Reference is made to the distinction between the *jus*

in rem, being the servitude proper, and the *jus in per sonam*, being the right to have the company maintain and operate the system, to point out that they have no necessary connection; that the price of the servitude may be paid once for all; while the compensation for the continuing maintenance and operation may, indeed must, go on indefinitely.

Booth vs. *Chapman*, 59 Cal., 149.

It seems to us that the facts pleaded in the answer show not only that the company's grantees have freehold servitudes, but that they have paid the whole price for them. From this it results that there is neither justice, equity, nor anywhere the power, to compel them to pay for the same thing again by way of annual rate. As to these lands the element of net revenue is for all time eliminated from the rates; the appurtenant "water rights" are paid for, forever.

All this is applicable to the cases of the defendants who purchased this irrigated land and took conveyances which made no express mention of their water rights. These all purchased under the express representation, with respect to the compensation for its personal obligation to maintain and operate the system, that is to keep the servitude in order, that the company's charge should be $3.50 per acre per annum. No equitable reason appears in this case why that rate should be superseded: for up to January, 1894, with only a fraction of the system employed, it yielded a net surplus of $49,699.28 (Answer, p. 26). From the bill and answer it appears that annual expense of maintenance and operation does not exceed $12,034.99 (Bill, pp. 5, 6,

Answer, p. 23). The gross collections amount to not less than $25,715 per annum, according to the Bill (pp. 5, 6) and will be for 1896 not less than $27,000, according to the Answer (p. 24).

The same legal conception of dominant and servient estate is applicable to the express contracts under which the company sold land and "water rights" after December, 1892. (See form of contract, Answer p. 15).

The only interpretation that contract will bear, is that it covers the sale of land with the freehold servitude on the water system annexed as appurtenant, for one price to be paid in *solido;* and that it contains the additional, separate and distinct covenant of the company, that the acre foot of water per annum shall "be "delivered by the party of the first part through its "pipes and flumes."

This latter is no more than a covenant that the diverting, storing and carrying capacity of the servient estate shall be continuously maintained and like continuous compensation be made in rates for such maintenance. It is the precise case of a pure freehold servitude, *plus* a personal obligation to keep it in repair, as described by Austin in the extract above quoted.

The same thing is true, *mutando mutandis*, as respects the contracts with owners of lands not bought of the company (Ans. pp. 18, 19); They comprise the sale of the servitude proper for its separate price, and also contains separate and distinct covenants to maintain in operation, for which, and for which alone, rates are to be paid. In each the servitude is paid for at prices fixed; the future maintenance is to be met by an annual rate.

Contracts of the latter class were enforced by the Supreme Court of this State in *Fresno Canal Co.* vs. *Rowell*, 80 Cal., 114; and in *Fresno Canal Co.* vs. *Dunbar*, 80 Cal., 530.

In the latter case it said (p. 535): "It was provided "that the right to the water to be furnished by the re- "spondent, should *be and become appurtenant to the land*, "and this was followed by an express agreement that the "contract to pay the money therefor should bind the "land. This, we think, created a lien on the land," etc.

The internal evidence is, that the express contracts here in question, were framed upon the precedent of those there enforced.

See also *Clyne* vs. *Benicia Water Co.*, 100 Cal., 310; for illustration of the creation of a "water right" as an appurtenant to land.

As respects those defendants who did not buy land of the corporation and who did not take written contracts for the easement of "the flow and use of water;" but who prior to December, 1892, fell into and now remain in that class of persons who "have been furnished water by it with which to irrigate their lands," under Sec. 552 of the Civil Code, we submit it must be held, that the statute executes the conveyance to them of servitudes on the system, as an appurtenant to their land, somewhat as the statute of uses executed the use by vesting the legal estate in the person in whose favor the use was declared or implied. This statute is not, in our judgment, to be construed as *compelling* a corporation to annex the "continued use of said water" to the land of such person for the same nominal annual rate as to the lands of those who have purchased of the corporation; that is to say, in disregard of the fact that

the company built the system, and the outsider not, for this would be confiscation.

But its intent is, to declare that in all cases where the corporation has voluntarily elected to furnish, and has begun to furnish water to lands not sold by it, on the same terms as to lands sold by it, and when upon the strength of this, the owner has improved and cultivated such land; that under such facts it does not require the lapse of five years to create the servitude by prescription; but such servitude arises directly and the statute operates to make the conveyance. It confers on the corporation the capacity to grant an easement by doing the act prescribed, as fully as it could by deed of grant.

Smith vs. *Green*, 109 Cal., 228, 234-5.

But in addition to all this the answer shows (pp. 28, 32) that the defendants in this class have been more than five years in the use and enjoyment of their easements, as of right; and aside from Sec. 552, in such cases, the law presumes after the lapse of five years, that a legal conveyance was made.

"It would seem that a title acquired by prescription is as strong as a title acquired by grant." Gould on Waters, Sec. 531.

Clyne vs. *Benicia Water Co.*, 100 Cal., 310.
Faulkner vs. *Rondoni*, 104 Cal., 140, 146.
Joseph vs. *Ager*, 108 Cal., 517.
Smith vs. *Green*, 109 Cal., 228, 235.

If "the use of the way, is under a parol consent "given by the owner of the servient tenement to use it "as if it were legally conveyed, it is a use of right. So

" an occupation of land under a parol gift from the " owner is an occupant as of right * * * In " such cases the law presumes, after the lapse of twenty " years, that a legal conveyance was made."

Stearns vs. *Allen*, 12 Allen, 582.

The bill of complaint avers that this class of defendants are *owners* of their water right, and makes no discrimination in the quality of their rights from those which it concedes to the other defendants; it makes no claim in this suit against this class of defendants to any different annual rate from that demanded of the other defendants. The corporation never has established any differential rate for this class from the first operation of its system in February, 1888, down to the present time. It has a standing rule (pages 19 and 20 of answer) by which, for the purpose of fixing rates for irrigating acre property, the lands are divided into two classes as follows:

" All lands to which the easement and flow of water " for irrigation has been or shall be annexed by the " consent or voluntary act of this company shall con- " stitute *the first class.*"

" All lands to which the easement and flow of water " for irrigation has not been or shall not be annexed " by the consent or voluntary act of this company shall " constitute *the second class.*"

The rule further provides that in addition to the annual rate (which is the same for both classes), that " there shall be paid upon the lands of said " class an annual charge equal to six (6) per " centum of the value of the right to said easement " and flow of water for irrigation which said value is to " be taken as $100 per acre."

This rule explicitly classes the easements of all

these defendants as being freeholds; and it provides a rate for such other would-be consumers as may not desire to contract for an easement in freehold; but shall desire the easement of the flow of the water in leasehold; and accordingly, the rule reserves rent for the use of such leasehold easement.

It would be hardly possible to bring the legal definition of the rights of all these defendants, by the company and their receiver more fully, than is done by this rule, within the first class of grants of a water course in law, defined by Jessel, M. R., as quoted by this Court in 46 Fed. Rep., 709, in these words: "The easement or the right to the running of water."

We desire to point out that in adopting this rule tenth, the corporation and receiver have followed the very distinction taken by Sec. 5 of the Act of 1885, which expressly authorizes the board of supervisors in fixing maximum prices, to discriminate between the sale and rental of water. We shall comment on this further on, in the endeavor to show that what the statute should be interpreted to mean is the sale or rental of the right to the flow of the water through its system and not the sale or rental of the water itself.

It is sufficient here to say, that the construction which the company has put upon the "water right" conceded in the bill to all the defendants equally, in all its sales, contracts, practice, rules and collection of rents, from the beginning of its water service, has been and still is, that such rights were, one and all, freehold servitudes on its system annexed as easements to the respective tracts of land; and this is the express provision of Sec. 552 in view of the facts in this case.

This being so, it is manifest that the claim of any legal or equitable right to any net income by way of rates to yield interest on the cost or value of the system is absolutely inadmissible—as much an attempted violation of vested rights, as to charge interest on the value of the land the company has been paid for and has deeded in fee.

And it being further true, that the $3.50 rate per acre per annum together with the domestic rates, yield even now, twice the annual expense of management, maintenance and operation, there is no color of right or equity for the attempted increase of rates to $7.00.

But in addition to this, is the fact of express representations by the company, to induce the purchase of its lands—at prices which it is self evident were for lands under irrigation—that the rates should be $3.50 per acre per annum, ripened into contracts by the acceptance on the part of its purchasers; and the fact of the establishment of this rate, by which others were induced to settle upon and improve lands not sold by the company.

Again as shown by the answer (pp. 31, 32) the $3.50 rate has been established for more than eight years, and for more than five years has been exacted from the defendants and their privies in title for maintaining and operating the system (pp. 31, 32, answer). It is alleged that this rate is in itself a servitude of toll, or rental by prescription on their lands, and therefore cannot be increased in burden by the corporation.

Civil Code, Sec. 802, Subdiv. 4; Sec. 811, Subdiv. 4; Sec. 1007; Statute of 1862, pp. 541-2, Sec. 5, which is the precursor of the Statute of 1885 and deals with

"rates, water rents or tolls." The term "tolls" was used by McKinstry J. in *Price* vs. *Riverside*, 56 Cal., 421-3, as synonymous with water rents.

That by the demand as of right and the payment as a duty for more than five years, this rate of $3.50 per acre has become a servitude on the defendants' land of toll or rental, within the definition of the statute; and that it has become established by prescription is fully supported by the case of

Whittenton Manufacturing Co. vs. *Staples*, 41 N. E. Rep., 441 (Mass. 1895).

That case, so far as this point was concerned, was a suit by the owner to collect one-fifth of the annual cost of maintaining a dam and drawing the water therefrom for the benefit of lower riparian premises, owned by another. The following extracts from the opinion will show the decision:

"No distinct agreement or stipulation being shown "calling for the payment of one-fifth of the cost of "maintaining the dam, we have to consider whether a "servitude has been imposed on the defendants' land "by prescription requiring such contribution * * " * * The one party collected the money as a "right; the other paid it as a duty."

Having shown that this continued for more than the length of time required to establish a prescription, in that State, the opinion continues:

"It would seem that the evidence is sufficient to es- "tablish such a servitude by prescription if in law such "a servitude can be so created."

And after discussing authorities:

"So, where a reservoir dam is maintained for the "benefit of several estates, the duty of repairs in whole, "or in a specified proportion, may be established by

" prescription as a charge against one of the estates in " interest. The duty of paying one-fifth of the reason- " able compensation for drawing water rests on the " same grounds."

" The right to take toll is called an easement."

Per Temple, C., in *Kellett* vs. *Clayton*, 99 Cal., 210, 212.

If this yearly rate of $3.50 per acre per annum has become a servitude on the defendants' lands by prescription, then, on well established principles, complainant's attempt to increase the burden was unlawful and the Court will not aid him (*Allen* vs. *San Jose Land & Water Co.*, 92 Cal., 138); unless, as he contends, the statute of 1885 empowers him so to do.

VI.

We are thus brought to the important matter of considering the bearing of the Art. XIV of the Constitution and of the Statute of 1885 upon this case.

As already suggested there is a well-founded dread on the part of many of the defendants, of the conception of the public control urged by complainant; and so there exists a tendency to rely upon the position that their relations to the company do not to any extent, not even in the control of maintenance rates, fall within the provision of the Art. 14, or of the statute.

The writer has hereinbefore urged the view, that by their contracts and under their vested rights, all of the defendants are absolved from rendering net revenue to the corporation; the obligation to pay the proper annual rate for maintenance, is conceded.

To what extent the matter of maintenance rates is

also by contract removed from public control, we shall leave to our associates to discuss; we shall also leave to them to present more fully their view as to how far the Art. 14 and the Statute of 1885 have no bearing on the case.

Complainant asserts that the whole matter of net revenue and maintenance is exclusively for public regulation; that no contracts can be made respecting easements in the water-works, which shall in any way affect rates; that the Statute of 1885 declares that there must be rates to comprehend both annual net revenue as well as annual maintenance; and that the parties concerned have no power to modify such supposed statutory scheme by contract.

We shall contend that if it be assumed that the whole matter of the relation of these defendants and the company, in respect of the water supply of water subject to appropriation, is subject to Art. XIV of the Constitution and to the statutes (Laws of 1862, 540; Civil Code, Sec. 552; Laws 1885, p. 96)—yet, the contract and property rights as asserted in the answer and as hereinbefore defined, are valid and maintainable in the courts.

There are two ways of looking at this provision of the Constitution and the statutes. The one regards them as disconnected from all that has gone before, as empirical, arbitrary; as striking out at a blow a novel order of things; as leaping into existence, new and complete in themselves, like Minerva out of the cleft skull of Jove.

There is another view, which cautiously interprets them by all that has gone before; which does not as-

sume that they were intended to overturn, disrupt and destroy the common conception of rights and institutions of property woven into the life of the people. Counsel for complainant contend for a construction of the former character; we contend for the latter. We adopt as a wise and salutary rule of interpretation the rule as stated in *People* vs. *Stephens*, 62 Cal., 233:

"Now these provisions, as well as the provisions of the Constitu-
" tion, must receive a practical, common sense construction. They
" must be considered with reference to the prior state of the law,
" and with reference to the mischief intended to be remedied by the
" change."

Rhode Island vs. *Massachusetts*, 12 Pet., 657, 723-4.
Slaughter House Cases, 16 Wall., 36.
Broder vs. *Water Co.*, 101 U. S., 276.
Lux vs. *Haggin*, 69 Cal., 442, 447-8, per Ross, J.

WHAT THEN IS THE PUBLIC USE DECLARED BY ART. XIV OF THE CONSTITUTION?

1. The phrase "public use" is employed in the Constitution with respect to waters open to "appropriation" as well as to others devoted to sale, rental or distribution; therefore it applies to the waters running on or through public lands of the State or of the United States, appropriated as shown by the answer.

Alta Land Co. vs. *Hancock*, 85 Cal., 219, 223.
City of Santa Cruz vs. *Enright*, 95 Cal., 105, 113.
Lux vs. *Haggin*, 69 Cal., 255, 426-8, 434.
Civil Code, 1422.

This being so, what constitutes an appropriation so far as this water supply is from the public lands is defined by

the Acts of Congress and Title VIII of the Civil Code and the decisions which construe them. The Constitution creates no new form, as, so far forth, it creates no new subject, of appropriation; as to such waters, it adopts the established signification of the term; it could not change the Acts of Congress; it has not assumed to change the law of the State in this respect.

2. But running waters on the public lands were open to the public to appropriate before the Constitution; they were, therefore, just as much a "public use" before, as since. So far as concerns this "public use," the Constitution is purely declaratory of the law as it was established before.

3. The law as established before, made it the one ruling, universal and indispensable condition to making a perfected appropriation, that the water must be *used for some useful or beneficial purpose.* Civil Code, 1411, which itself is declaratory.

There is nothing consummated, substantial or enduring in the whole conception except the *actual continued use.*

Everything else is but a means subordinate to this end. This is as true of the diverting and conducting works built by another for the use of the consumer, as it is of such works which the consumer builds for himself.

4. Irrigation of land in private ownership is a useful and beneficial purpose, within the law of appropriation.

It follows, that the appropriation of the use of water upon or from the public domain to irrigate land, in private ownership, involves the converting of what before was open to the "public use", into a *private one,* which thus becomes private property

and appurtenant to the land. This is the very meaning of "appropriate"—to set apart for one's self in exclusion of all others; to segregate from that which before was open to the public, a portion or the whole, to the use of the individual; and "as between appropriators, the first in time is the first in right." Sec. 1414, Civil Code, which is also merely declaratory.

What we contend is, that these essential ideas inherent in the nature of an appropriation for irrigation, to-wit: *the creation of private property rights to the use of water as appurtenant to land, with priorities*, survive the Constitution; and, that they survive it in the specific case where another than the land-owner, for business and profit, diverts the water and conducts it to the land. And more—that these essential elements of a complete appropriation of the right to the use of water, are the very things which the Constitution was intended to declare and lay up in the fundamental law against corporate monopoly or public interference.

How gross a perversion then, to interpret the Art. XIV as destroying the great central and beneficent ideas, which vitalize the appropriation of the use of water for irrigation, to-wit:

First. The acquisition of the right to such use as private property, appurtenant to the land irrigated; and as a necessary incident, the capacity to acquire, by fair contract, a property right in the diverting and conducting works, or in their service.

Second. The priority and protection of such rights against all who come afterward. This really follows as a necessary corollary to the conceptions of private property in the use of water for irrigation.

We contend that all the relations of the corporation in this case to the consumers of water for irrigating their lands, must necessarily be, and by the Constitution and statutes are to be, harmonized and co-ordinated with these primary and fundamental principles.

And we contend that under the Constitution and statutes, all public control and regulation of the use of water for irrigation must bow to these same imperative principles.

It will be convenient in the further discussion, following the example of Helm, J., in *Wheeler* vs. *Irrigation Co.*, 17 Pac. Rep., 487, 489, to use the term "carrier" and "consumers" meaning the corporation in what is assumed to be its *quasi-public* capacity, and the defendants as tillers of the soil, respectively.

We may further use for the purpose of designating the whole aggregation of rights involved in a perfected appropriation of the use of water for irrigation of land, comprising the right to the continued use of the water, with protected priorities, together with the property rights acquired in the works used for diverting and conducting the same, all made appurtenant to the land of the consumers, by the common and convenient term "water right."

"The right to the water or *water right*, as it is commonly called, " is only acquired by an actual appropriation and use of the water."

Nevada Company, etc. vs. *Kidd*, 37 Cal., 282, 310, per Sawyer, J.

VII.

Given the principle, that the consumer may in some lawful way acquire private property rights in the

use of water for irrigation, by appropriation ; that such rights may be made appurtenant to his land ; and that the Constitution and statutes have not destroyed, but confirmed, the institution of property comprehending such rights, in the case where the carrier intervenes to divert and conduct the water—then we contend, that it follows :

1. That the carrier is not in the true sense an appropriator of water. And that its diversion and carriage of the same, invests it with no title to, or property right in it, or its use, of which it can dispose.

That the consumer who has lawfully, through the agency of the carrier, applied the water to his land, is the only owner of a "water right". This results:

a. Because the Constitution expressly declares that notwithstanding any attempted appropriation for "sale, rental or distribution", the water shall nevertheless remain a public use and therefore open to appropriation, as it was before.

b. Because under the law of appropriation, the diverting and carriage of water for hire is not in itself "a useful or beneficial purpose", but only a means to that end.

That therefore the carrier has nothing which it can sell or rent, except an interest in or use of the property which it does own, to-wit : its diverting, storing and distributing system.

It would seem that the brief for complainant concedes that the carrier had no title or property right in the water or its use which it can sell or rent. On page 10 of the typewritten "points and authorities" of our opponents, in support of the exceptions, it is said : "The com-

" modity in which he deals is not his own, he is a mere " agent of the public in appropriating and delivering it." (lines 3. 4. 5). Again with respect to the value of the plant, it is said : "Is the water right of the company, or " the water stored by it to be considered? If so, how " can the value of the water rights, or the water, be as- " certained, and what is the interest of the company in " what the Constitution makes a public use?" (lines 15-18). We agree with counsel that water and water rights must be excluded from any valuation of the property of the company ; and the statute does exclude them ; for the sufficient reason that *as a mere carrier* it owns, and, under the Constitution, can own neither.

What then is the vital point of difference between us?

It is in the diverse conceptions of the public use declared by the Constitution. Instead of accepting that which we have endeavored to state, counsels' idea seems to be that the *public* appropriates the water, and that the carrier is the agent of the *public* in so doing. Counsel, as quoted above, uses the phrase "he is a mere " agent of the *public* in appropriating and delivering it." This is the Spanish conception and not the Anglo-Saxon.

Vernon I. Co. vs. *Los Angeles*, 106 Cal., 244 6.

The complainant, in argument, goes to the whole length of the theory that the water is owned by the public in its organized capacity ; that in this case, the public is represented by the county board ; and that the carrier is a purely and not merely a *quasi*-public agency for effecting the appropriation of water for such organized public ; and to deliver it on its behalf to the units of that public ; and that as such purely public agency, it has the

delegated power to fix the rates from time to time, subject only to the appellate power of the board—to revise them or substitute others.

This is the precise result to which counsel came in the third paragraph of their Points (p. 2, lines 14-23).

It will be observed that this eliminates all volition on the part of the consumer; it ignores his capacity to acquire easements and servitudes as completely as though the attempt were to get an easement in or servitude upon a city water works, or a court house or a school house; it denies to him any right to contract; he has no voice of his own; on his side everything is delegated to the board.

Here is the storm center of the whole controversy over the construction of the Constitution and statutes. Both the carrier and consumers in this case have thus far regulated their relations entirely by contract. They have dealt with the subject in the way of their race, treating the whole matter as of private and not State initiation. The whole history shows this. All at once the carrier coolly ignores all contracts it has entered into and all grants it has made; repudiates all rights that have vested; and with the greatest naivete declares that it is all a matter of State regulation; and for the purposes of such regulation, for the time being, serenely announces, like Le Grand Monarque, "I am the State."

To this conception submission will never be made. If that had been, as counsel contends, and we deny, the legislative conception embodied in the Act of 1885, it will meet, at the hands of the Courts, the fate of the Statute of Uses, of which Sir Edward Sugden said: "This should operate as a lesson to the Legislature not

" vainly to oppose the current of general opinion, for al-
" though diverted for a time, it will ultimately regain its
" old channels " Gilbert Uses Introd., LXIII.

Or to use Mr. Washburn's language on the same subject, we shall have another " remarkable illustration of " the irresistible power of the common will of a people " to make for itself such amendments in the existing " laws as their necessities demand, independent of the " recognized system of legislation with which a State is " governed," 2 Wash. Real Prop., 93.

The whole history of the indigenous institution of the appropriation of water shows this.

We shall undertake to prove from decided cases under a Constitution which, like our own, declares the use of running water to be dedicated to the use of the people, that such a carrier acts as the agent of the *consumer* and *not* of the public in the appropriation and delivery of the water. This changes the whole face of the thing.

But before going to the decided cases, we recur to the record in this case, and ask what, in counsel's view, has become of the *water rights*, which the bill avers are *owned* by the respective defendants; and which the answer admits and avers are so *owned;* and what becomes of the averment in the bill that the defendants have " *by purchase* or *otherwise* " become such owners, which is also admitted in the answer?

In ordinary cases an ultimate fact alleged in the bill and admitted by the answer, establishes that fact for the purposes of the case. What does counsel ask the Court to do with *this* fact?

" Owner " in its general sense, means one who has full proprietorship in and dominion over property.

Directors F. I. District vs. *Abila*, 106 Cal., 355, 362-3.
Johnson vs. *Crookshank*, 21 Or., 339.

And by necessary implication the bill avers that such ownership was derived from the company by "purchase or otherwise;" and that this is the meaning of the averment, is shown by the acts and contracts of the company set forth in the answer.

If, as counsel concede, the water is not a commodity which the company owns; that it is a mere agent; and that as such agent, it has no interest upon which value can be predicated, "in what the Constitution makes a public use," to-wit, the water; then, what element in or constituent of the water rights does the bill allege to have been acquired by the defendants by "purchase or otherwise" from the company? Have the company and these defendants been under the influence of a huge delusion all these years, contracting, paying and receiving money, for so much moonshine?

To this complexion indeed comes the argument of counsel.

We differ; and, venture to believe that the more rational explanation is, that the company was selling, and if you please, giving away, servitudes upon its works; and that this element of the water right is the precise thing of which defendants have, by purchase or otherwise, become the owners, through their dealings with the company; the use of the water they get under the Constitution and the laws, on their own merits, by using it; and not from the company. To be sure, to be able to use it, they were compelled to employ the service of the storing and distributing system of the company.

Therefore that and that only was the subject of all the contracting with the company and of the ownership derived from it.

It has been decided under the Constitution of Colorado, by the courts of that State after repeated consideration, that such corporation is neither the appropriator of the water, nor the true and ultimate proprietor of the use of the water; that the true appropriator for irrigation is the consumer and he alone.

Sec. 5, Art. XVI of the Constitution of that State is as follows:

"Sec. 5. The water of every natural stream, not heretofore appropriated, within the State of Colorado, is hereby declared to be the property of the public, and the same is dedicated to the use of the people of the State, subject to appropriation as hereinafter provided."

The Constitutions of the two States, Colorado and California, the one in the phrase, "dedicated to the use of the people," and the other in the words, "dedicated to a public use," announce one and the same principle.

Therefore, the decisions in Colorado, under this principle, in defining the *status* of the carrier, where the questions are not covered by the decisions of this State, are of very great authority, both from the great consideration which these questions have there received, and by reason of the high character of the Court.

The opinion in the case of *Wheeler* vs. *Irrigation Co.*, 17 Pac. Rep., 487, fairly broke the ground on this class of questions. We quote extracts. Speaking of the carrier, it holds that its "diversion ripens into a valid appropriation only when the water is utilized by the consumer." (pp. 488, 490).

Treating of the exceptional status of the carrier, it says of it:

"Certain peculiar rights are acquired in connection with the water "diverted. It is unnecessary now, however, to enumerate these "rights in detail; for the present it suffices to say that they are de- "pendent for their birth and continued existence upon the use made "by the consumer. But, giving these rights all due significance, I "cannot consent to the proposition that the carrier becomes a "'proprietor' of the water diverted." (p. 490.) "The carrier "must be regarded as an intermediate agency existing for the pur- "pose of aiding consumers in the exercise of their constitutional "rights as well as a private enterprise, prosecuted for the benefit of "the owner." (pp. 491-2)

The Court makes observations which are pertinent to the construction of the phrase "appropriated for sale, rental or distribution," in Art. XIV. and the phrases in the Statute of 1885, such as that in Sec. 5 in the words, "rates at which water shall be sold, rented "or distributed," etc., as follows:

"A cursory reading of the statute might convey the impression "that the legislature regarded the carrier as having a salable inter- "est in this water. And the constitutional phrase 'to be charged "for the use of water,' relating to the carrier's compensation might "at first glance seem to recognize a like ownership in such use. "But construing all the provisions of this instrument bearing upon "the subject *in pari materia*, the correctness of both these infer- "ences must be denied. The constitutional convention was legis- "lating with reference to the necessities and practical wants of the "people; and this body in its wisdom, ordained that the ownership "of water, shall remain in the public, with a perpetual right to its "use, free of charge, to the people. By Sec. 8, Art. 16, of the con- "stitution, from which the foregoing phrase is taken, the conven- "tion recognizes the carrier's right to compensation for transporting "water, but provides for the judicial or *quasi* judicial tribunal to fix "an equitable maximum charge where the parties fail to agree. It "requires no citation of authority to show that the words, 'pur- "chase' and 'sale' together with other words of like import, used "in this connection by the legislature, must receive a corresponding "interpretation."

In *Platte Water Co.* vs. *N. Col. Irri. Co.*, 21 Pac. Rep., 711, 712, the Court quoted with approval, this further extract from *Wheeler* vs. *Irrigation Co.*, *supra:*

"The diversion of the water ripens into a valid appropriation "only when the water is utilized by the consumer, though the pri- "ority of such appropriation may date, proper diligence having "been used, from the commencement of the canal or ditch."

As showing the personal or individual character of appropriation under such a constitutional provision we quote from *Reservoir Co.* vs. *Southworth*, 21 Pac. Rep., 1028, by Hayt, J., the following:

"In the light of these decisions, it seems clear that, at least under "some circumstances, different users of water, obtaining their sup- "ply through the same ditch, may have different priorities of right "to the water, that the appropriations do not necessarily relate to "the same time."

And from page 1029, *Ibid:*

"It is well established that no mere diversion of water from a "stream will constitute the constitutional appropriation. To make "it such it must be actually applied to the land before the appro- "priation is complete."

And after quoting from *Wheeler* vs. *Irrigation Co.*, *supra*, an extract above set forth, he continues:

"It is apparent from these decisions that the priority of appro- "priation which gives the better right is a legal conclusion, resulting "from certain facts; the diversion of water from the stream, and its "application to a beneficial use."

And per Elliott, J., in the same case (p. 1030):

"The appropriation of water within the meaning of the constitu- "tion, consists of two acts: *first*, diversion of the water from the "natural stream; and, *second*, the application thereof to beneficial "use. These two acts may be performed by the same or different "persons; but the appropriation is not complete until the two are "conjoined."

And further on the same page (1030):

"Can the carrier of water for hire be said to be using the water "in the sense spoken of in the constitution? * * From "the specification of the purposes for which water may be used it "would seem that the 'better right' which attaches to priority of ap- "propriation was primarily intended for the benefit of those who

"apply the water to the cultivation of the soil or other beneficial "use, rather than for the benefit of those engaged in diverting and "carrying it for the use of others. The diversion and carriage of "water, in point of time are necessarily prior to the application of it "to agriculture or other useful purposes; but they are subordinate "in point of right. The former are to the latter as the means to the "end, an end without which neither the diversion nor the carriage "would be lawful. The carrier is the agent, the consumer is the "principal. The former can lawfully pursue his occupation only by "virtue of the service he renders to the latter. The consumer's "right is primary, and unconditional; the carrier's is secondary and "dependent."

"Every consumer cannot take water directly from the natural "stream. Irrigating ditches and canals must be resorted to as a "means of diverting and carrying water to places where it can be "beneficially applied. *No good reason can be urged why a con-* "*sumer, obliged to make use of such agency, should not be protected* "*equally with those taking water directly from the stream.*"

The judge was here speaking with direct reference to priorities; but the principle is just as applicable to the protection of the consumer's capacity to acquire a fixed property interest in the water works of such agency, by way of servitude.

In answer to the spurious view of the "public use" declared by our Constitution, that it forbids priorities of right in the use of water, with the necessary incident of priority of right to the servitude upon the system; and that such declaration implies that a given water supply for irrigation of this public character, is dedicated to unending division and sub division, to continual adjustment and readjustment between earlier and later consumers as their demands and increasing numbers shall press upon the supply, we quote further from the opinion of Elliott, J., p. 1032, *Ibid:*

"A single illustration will suffice to show the disastrous conse- "quences which would ensue if the prorating statute should be "made the rule for the distribution of water for purposes of irriga- "tion, instead of the rule of priority. An irrigating ditch is con- "structed, the first and only one, taking water from a small natural "stream. The first year five consumers apply for and receive each

"one hundred inches of water for the irrigating of their lands; the "next year, the ditch being enlarged, five more apply and receive "a like quantity; and the third year five more; and so on succes- "sively until thirty or forty consumers are located under the ditch. "Perhaps the first five might be required to prorate with each other "in time of scarcity, should their appropriations be practically "equal in point of time; but under the statute, the first five would "also be compelled to prorate with all subsequent consumers, until "the amount of water that each would receive would become so in- "finitesimally small as to be of no practical value, and would event- "ually be entirely wasted before it could be applied."

What the effect would be on the orchard interests of Southern California, to inaugurate a system of perpetually dwindling water supplies, and maintain it under the Constitution by the strong arm of the law, requires no prophetic gifts to foresee.

We can indulge no fear of the possibility of a judicial reversal of the principle of exclusive appropriation to continued beneficial purposes of any water subject to the public use.

Helm, C. J., in the same case says (21 Pac. Rep. 1034):

"There is therefore no escape from the conclusion hitherto an- "nounced by this Court, that in cases like the present the carrier's "diversion from the natural stream must unite with the consumer's "use in order that there may be a complete appropriation within the "meaning of our fundamental law."

In *Combs* vs. *Agricultural Ditch Co.*, 28 Pac. Rep., 966, 968, there was an attempt to enforce a by-law of the ditch company, as follows:

"(1) No water shall be sold from the company's ditch, except to stockholders."

After holding that the company was not purely a mutual one, the opinion holds the language:

"The ownership of a prior right to the use of water is essentially "different from the ownership of stock in the irrigating company. "The ownership of stock, like the title to other property, may be

" acquired by descent or purchase. The ownership of the prior " right can be acquired originally only by the actual, beneficial use " of the water. The very birth and life of a prior right to the use of " water, is actual user. The stockholder in an irrigating company " who makes an actual application of water from the company's " ditch to beneficial use may, by means of such use, acquire a prior " right thereto; but his title to the stock without such use gives him " no title to the priority."

In *Fort Morgan Land and Canal Co.* vs. *S. Platte Ditch Co.*, 30 Pac. Rep., 1032, involving the rights of ditch companies, the syllabus by the Court contains the following:

"2. By a diversion and use for irrigation, a priority of right to " the use of the waters of the natural streams may be acquired. " This priority is a property right, and, as such, is subject to sale " and transfer.

"3. There must be not only a diversion of the water from the " stream, but actual application of it to the soil, to constitute the " appropriation for irrigation, recognized by the Constitution. A " diversion, unaccompanied by an application, gives no right."

Oppenlander vs. *Left-Hand Ditch Co.*, 31 Pac. Rep., 855-6.

The citation of this case is to the point that water rights for irrigation of land acquired by appropriators and consumers under an incorporated ditch company, by contract with it for an interest in the ditch, evidenced in the case cited by shares of stock, are such property that (*Ibid*, p. 857) " they may undoubtedly be " severed from the land, and may be sold and conveyed " separate and apart therefrom;" subject always to the condition that such an owner "can only transfer his " priority to some one who will continue the use of the " water." (*Combs* vs. *Ditch Co.*, 28 Pac. Rep., 966, 968); but the use may be a different one (*Kidd* vs. *Laird*, 15 Cal., 162; *Davis* vs. *Gale*, 32 Cal., 27; *Strickler* vs. *City of Colorado Springs*, 26 Pac. Rep., 314; *Ramelli*

vs. *Irish*, 96 Cal., 214, 217; *Jacob* vs. *Lorenz*, 98 Cal., 332, 340; Civil Code, Sec. 1412.)

The principle that the carrier of water, as such, by its diversion of the water and construction of its water works does not become the appropriator of the use of the water; acquires no proprietory right therein; and that the diversion ripens into a valid appropriation only when the water is utilized by the consumer, is further illustrated by the later decisions by the Colorado Court of Appeals.

Farmer's Ditch Co. vs. *Agl. Ditch Co.*, 32 Pac. Rep., 722.

Col. Land & Water Co. vs. *Rocky Ford, etc., Co.*, 34 Pac. Rep., 580, 583.

An attempt had, however, been made earlier by the majority of the Court of Appeals of that State to establish the contrary doctrine, to-wit: That under such circumstances the company became the owner of the water as a commodity to be sold by it, by an elaborate opinion in *Wyatt* vs. *Larimer & Weld Irrigation Co.*, 29 Pac. Rep., 906, in which a rehearing was denied.

This case was thereupon appealed to the Supreme Court of that State and its original opinion and opinion on rehearing are reported in the 33 Pac. Rep., 144. The Court say (p. 147) upon this subject:

"We adhere to the doctrine that such a canal company is not the "proprietor of the water diverted by it, but that it must be consid- "ered as an intermediate agency existing for the purpose of "aiding consumers in the exercise of their constitutional rights, as "well as a private enterprise prosecuted for the benefit of its "owners."

These Colorado decisions have but carried to the logical conclusion in cases touching the status of cor-

porations engaged in the carriage of water, the doctrines which have always prevailed in the courts of this State, that "the property is not in the *corpus* of the water, but only in its use."

N. C. & S. S. Co. vs. *Kidd*, 37 Cal., 282, 310, Per Sawyer, C. J.
Eddy vs. *Simpson*, 3 Cal., 249, 252.
Kidd vs. *Laird*, 15 Cal., 179, 180.
Davis vs. *Gale*, 32 Cal., 27, 34, per Sanderson, C. J.

VIII.

We have thus, at perhaps undue length, cited decisions to show, what opposing counsel seem to admit, that the corporation has no title to the water diverted; has no water to sell; and must be considered as an intermediate agency to aid consumers in the exercise of their constitutional rights, to appropriate the water to irrigate their lands, as well as a private enterprise of its owners.

We have done so, to show that the premises just stated are established beyond question.

For it follows from them with unerring certainty, that if the carrier may make a contract of sale or rental with the consumer at all, the subject of such contract is not the water; and must therefore be some interest in the water works. And since all concede that by any such sale or rental of some interest in the works the title of the carrier is not divested; and that the consumer only acquires the right to connect them with his land, enjoy their service in delivering the water which he is thus enabled to appropriate; it also follows that

the interest in the works which can be thus *sold* is a freehold servitude; and, which can thus be *rented* is a leasehold servitude.

It is next to be inquired whether the consumer as principal may make such contracts with the carrier as his agent; whether the fact that the carrier is "affected with a public interest," destroys its capacity to contract as a private corporation.

This question was touched upon in *Wheeler* vs. *N. Col. Irrigation Co.*, (1888) 17 Pac. Rep., 487, 493; in *Farmer's, etc., Canal Co.* vs. *Southworth*, 21 Pac. Rep., 1028, 1031; wherein it was assumed that there might be "contractual relations;" but only emerged in clear decision in *Wyatt* vs. *Larimer & Weld Irrigation Co.*, 33 Pac. Rep., 144.

In Wheeler case, *supra*, the question was whether as a condition precedent to granting the use of water to a would-be consumer, the carrier could compel him to sign a contract "That he buy in advance 'the right to "receive and use water' from its canal, paying therefor "the sum of $10.00 per acre" (p. 491).

The similarity between the question in that case and the case of *San Diego Land & Town Co.* vs. *National City*, recently decided by this Court on the question of the right to exact the price of a "water right" is striking. The Colorado case holds as this Court did, that such exaction is illegal and unconstitutional. And to the same effect is the holding as to an exaction attempted to be made for the price of a "water right" in *Combs* vs. *Ditch Co.*, 28 Pac. Rep., 966; in another form, *i. e.*, by a by-law requiring the purchase of stock

in the corporation as a condition precedent to the service of the ditch.

In the case of Wheeler, Helm, J., however, by way of precaution said:

> "I must not be understood as intimating that this demand is "illegal *per se;* and if the consumer, prior to 1887, saw fit to waive "his right, by voluntarily submitting thereto, both the legislature "and courts may be alike powerless to relieve him from the legiti- "mate results of his contract."

So the Combs case must not be considered as holding the provision in the by-law for sale of stock to the consumer as illegal except, as put by Justice Elliott, p. 967, when used for "*compelling* the purchase of stock "as a condition precedent to use" of the water; for the same Court, in *Oppenlander* vs. *Ditch Co.*, 31 Pac. Rep., 854, while citing and relying on the Combs case, held (p. 857) that the severance, sale and conveyance of a water right, under a ditch company, appurtenant to land, may take place "by the assignment and sale "of stock representing water rights in an incorporated "ditch company."

But finally in the Wyatt case (33 Pac. Rep., 144) the Court clearly holds that a consumer for irrigation of land under a carrier of this *quasi*-public character, may, by contract with such corporation acquire a freehold servitude in the ditch annexed as an easement to his land.

The object of the plaintiffs in that case suing for themselves and all other users of water except the defendant company, who obtained their supply from the canal of the company by virtue of the water right contracts issued by the company, was to enjoin the company from selling additional water rights, or entering into further water

right contracts, providing for prorating of the water flowing in its canal. In order to give jurisdiction to the Supreme Court, it was necessary to decide whether the interests of the plaintiffs in the canal were freehold estates. We quote the following extracts from the opinion: (p. 147.)

"The right to the relief demanded in this action is predicated "upon, and must be determined by, the terms of the contracts en- "tered into by the respective parties; and, while those contractual "rights are analogous to the rights guaranteed by the Constitution "to appropriators of water, the action involves only the considera- "tion of private contracts between the ditch company and the "plaintiffs, and no constitutional question is involved in the decision "of the case. The jurisdiction of this Court by appeal, therefore, "depends solely upon the question whether the action relates to the "freehold. * * * It is therefore necessary to ascertain "and define the nature and kind of property claimed by plaintiffs "in the water rights in question, and whether the nature and extent "of their interests therein constitute freehold estates, and whether "this action relates thereto. * * *

"The plaintiffs allege a right to have a certain quantity of water "flow through the irrigation company's ditch. This right is an "easement in the ditch. It is a right annexed to realty, and being "a perpetual right is an incorporated hereditament, descendible by "inheritance to plaintiffs' heirs, and hence a freehold estate." *

After holding that the canal company is not a proprietor of the water, in the passage hereinbefore quoted (p. 38) from the same opinion, the following passages occur:

"The status of the defendant company could in no aspect affect "these rights. Its duty to these plaintiffs would be the same "whether that duty was to furnish water under their contracts as "proprietor *or carrier* of water * * *

"The company is the owner of the canal whereby it proposes to "divert water from the Cache la Poudre river for the use of the "farmers owning land capable of being irrigated therefrom."

The Court reached the conclusion "that appellants "have certain well defined rights that will be mater- "ially impaired if defendants do the act threatened." And held that the cause was clearly cognizable by the

Court of Equity. In the opinion on rehearing, the Court adhered to its judgment and in the course of its opinion, after defining and citing authorities defining an easement, said:

"The right to acquire water by an appropriator under our system "is of the same character as that defined by the foregoing authori- "ties as an incorporeal hereditament and easement. *The consumer "under the ditch possesses a like property.* He is an appropriator "from the natural stream, through the intermediate agency of the "ditch, and has a right to have the quantity of water so appropriated "flow in the natural stream, and through the ditch for his use."

Thus the Colorado Court under a constitutional declaration like our own, reasoning from the principles of the common law defining easements and servitudes, reaches the same result as declared by Section 552 of our Civil Code.

And it is to be remembered that this section of the Code co-existed with the Statute of 1862, page 540, which contained the provision that the rates, water rents or tolls established by corporations from under that act, should be "subject to regulation by the board "of supervisors of the county or counties in which the "work is situated, but which shall not be reduced by "the supervisors so low as to yield to the stockholders "less than 1½ per cent. per month upon the capital "actually invested;" so that it is impossible to say that in the legislative intent up to the time when the Constitution was adopted and the Act of 1885 passed, the subjecting of water rates to regulation by the board of supervisors was inconsistent with the acquisition of such easements appurtenant to land as are defined in Sec. 552 of the Civil Code. We are next to inquire whether the Constitution and the Act of 1885 has su-

perseded the Sec. 552, or whether they stand consistently together.

IX.

And in this connection and before taking up the Act of 1885, we take occasion to advert to the assumption made in the oral argument in behalf of complainant, that the decision of this Court in the National City case, against the complainant's *theory* of a water right there advanced, was fatal to the claims of these defendants to their water rights in this case. This assumption was seized upon as furnishing judicial sanction for the repudiation by the company of all the contract rights of these defendants, a repudiation which, however convenient to complainant for the immediate purposes of this case, would cut out the foundation from under all future business and prosperity of the company.

To probe this assumption, it is necessary to dissect the theory of water rights put forth in the National City case.

In the first place, the company there claimed that because there was not water enough for all the land, it had *priorities in the use of water to sell;* that such priorities were *its* property; and that to compel it to begin to furnish water to irrigate land, operated under the Sec. 552, to annex an easement to the land, for which it was entitled to demand pay *over and above annual rates*, though these rates in fact and in legal contemplation yielded both the reasonable operating and maintenance expenses, *and* all such compensation on the money invested in the purchase and construction of the

works as it was entitled to by law.

The same conception is advanced in this case, as shown by the construction which was put upon the formal contracts shown in the answer, at the oral argument and is now put by the points filed for the receiver. Take the case of "water right" sold by the company in connection with its land (pp. 15, 16, answer); by the terms of the contract the corporation "agrees to sell unto the " party of the second part, and the party of the second " part agrees to purchase of the party of the first part " the following real estate, to-wit :" (description) "*to-* " *gether with a water right to one acre foot of water per* " *annum* for each and every acre of said above described " real estate, to be delivered by the party of the first " part through its pipes and flumes at a point..... .. " said water to be used exclusively, on said real estate, " and to become and be appurtenant thereto, and not to " be diverted therefrom. Provided that the party of " the first part may change the place of delivery of said " water so long as the same is near the highest point " of said land. *For which land and water right* the " party of the second part agrees *to pay*..... " *Dollars.*

"And the party of the second part further agrees " and binds himself.....to pay the regular annual " water rates allowed by law and charged by the party " of the first part for *the water covered by said water* " *right.*"

The contract is substantially the same so far as the sale of the water right is concerned, where made with those who did not buy land from the company; but in those cases the price of the water right is specifically

fixed, earlier at $50 and later at $100 per acre (Answer pp. 17, 18).

Now counsel claim that *under those contracts* the annual rates must be commensurate with "the cost per "annum of operating the plant, including interest paid "upon money borrowed, 'to make good' the annual de- "preciation of the plant," *and* "a fair profit to the com- "pany either by way of interest on the money it has "expended or upon some other fair and equitable "basis." (Page 8 of Points par. 11) In short, counsel deliberately claim, that notwithstanding the company has sold and taken pay for "water rights" that that part of the contract has no effect on the "rates allowed by law," which must cover both maintenance and operation, *and* net revenue not less than 6 nor more than 18 per cent. per annum on the cost of the plant.

Under this conception what did the company sell and what did the consumer receive in consideration of his $50 or $100, or what not higher sum, per acre covered up in the price of land *and* water right at $300 to $500 per acre? If notwithstanding such payment in advance, the consumer must pay in annual rates all the carrier could in any event collect for annual reasonable expenses in repairs, management and operation of its works and also for net revenue and profits on the cost thereof, what is the nature of the demand for the price of a "water right"? Truly, as this Court held in the National City case, it is without basis; for if paid it must have a bearing on the annual rates; and a theory which denies that it has such bearing, and still claims the right to enforce the demand, insists upon pure ex-

tortion from the consumer of so much money as a condition precedent to his exercise of his constitutional rights. This *theory* of the company and receiver it was which made shipwreck on the constitutional rock and broke into smithereens under the decision of this court.

But we are confronted here by "a condition and not a theory." The question is, whether the complainant after having pocketed the money is at liberty to put forth, in order to gain a short-sighted advantage, a construction upon these contracts which would make them unconstitutional. We submit not, if any other construction is to be found. Such construction is to be found in giving to the contracts their natural meaning, as being grants of freehold servitudes on the system for a price paid; and in holding that the bearing of this upon the "annual water rates allowed by law" is that it eliminates from them the whole element of net revenue; this is the principle of the classification of lands by the company and Receiver made as set forth in the answer (pp. 19, 20); and that rule of classification is what every consumer believed, and had a right to believe was the principle which has regulated these rates from the beginning.

We quote from *Wyatt* vs. *Larimer & Weld Irrigation Co.*, 33 Pac. Rep., 144, 149, the following pertinent extracts:

> "If the terms of a contract admit of two meanings, one of which "would render the contract unlawful, and the other lawful, the lat-"ter construction must be adopted. Doubtful words and provisions "are to be taken most strongly against the grantor, he being sup-"posed to select the words which are used in the instrument."

And the following from *Noonan* vs. *Bradley*, 9 Wall., 395:

"Where doubt exists as to the construction of an instrument pre-
"pared by one party, upon the faith of which the other party has
"incurred obligations, or parted with his property, that construction
"should be adopted which will be favorable to the latter party; and
"where an instrument is susceptible of two constructions * *
" * the one working injustice, and the other consistent with
"the right of the case * * * that one should be fav-
"ored which upholds the right."

The acts of the company in relation to these contracts are persuasive, if not of controlling weight, in their interpretation.

And the Court further quotes the following from the case of *Chicago* vs. *Sheldon*, 9 Wall., 54:

"In cases where the language used by the parties to the contract
"is indefinite or ambiguous, and hence of doubtful construction,
"the practical interpretation by the parties themselves is entitled to
"great, if not controlling, influence."

And we may say, as the Court did in the Wyatt case, that in whatever aspect these contracts are considered, whether upon the plain import of the language used, or by regarding certain terms as of doubtful meaning, their interpretation must be favorable to the contention of these defendants.

The contracts created the titles to the servitudes; these became fixed and vested rights. The principle governing the annual rates adjusts them to those rights; and that principle dictates that they should be confined to the annual expenses of operation and maintenance, and should exclude net revenue.

X.

The Act of 1885.

By Art. 14 of the Constitution, the regulation and control reserved to the State over rates or compensa-

tion for use of water supplied to the inhabitants of any county outside of any municipality is left to be exercised under the authority of and in the manner prescribed by law, *i. e.*, statute law.

We are to look then to the statutes as they stand for the rule of decision; and these are Sec. 552 of the Civil Code and the Act of 1885; the Act of 1862 is impliedly superseded by the Act of 1885, though it has not, we believe, been in terms repealed.

The Statute of 1885 on its face, assumes that the carrier and consumer have voluntarily established for themselves and without the intervention of any public authority, relations to each other, in which somehow certain water "rates" have become established (last sentence of Sec. 5). These rates are further described as being "actual" and "collected". So far forth the statute institutes nothing; it simply describes a situation; a situation common to this semi-arid region, where the legislature has noticed, and the courts will take judicial notice, that by the co-operation of the corporations and the settlers, deserts have, in a decade or less, been converted into thickly settled communities.

These communities are not penal colonies seated on these arid tracts under compulsion of law, and by law compelled to take land and water supply at rates dictated by the State. They came induced by the representations of enterprising capitalists who had developed irrigating schemes, almost universally in connection with schemes for the sale of land so irrigated.

The present cause is in its facts, an excellent illustration of the conditions which the legislature had in view in passing the Act of 1885, and has been described

with great accuracy by this Court in the National City case.

It is sufficient here to say that the whole history is one of contract; of offers by the corporation of land with water at certain prices in lump sum, and at a certain annual water rate thereafter, accepted by the settler; of offers of water supply at the certain annual rate accepted by those who did not purchase land; later, of formal contracts conveying land and water rights, and water rights without land, in which figure prices paid in gross for the "water rights", with provision for an annual rate besides. This legislation is adapted, fitted, to this state of things; it is not intended to overthrow it, but to supplement it, by providing means for correcting any abuses and for meeting certain exigencies, and enforcing justice and equity between all parties, which it would be impossible to do if the contract rights were disregarded.

It is then the simple historical fact that "the actual "rates established and collected by each of the * "* * corporations now furnishing, or that "shall hereafter furnish appropriated waters for sale, "rental or distribution to the inhabitants of any of the "counties of this State" were so established by *contract* between the carrier and consumer; and that the law (Sec. 5) so regards them. And the important consequence follows, that when the law declares that such "actual rates established and collected * * "* shall be deemed and accepted as the legally estab- "lished rates thereof;" the statute simply adopts and confirms the contract relation and converts it into a legal *status*. It is a *status* that must remain undis-

turbed by carrier or consumer, until rates shall be established by the board of supervisors as provided in the Act; and then it can only be revised as to existing consumers with due regard to their vested rights, as well as to the vested rights of the company. To that *status* the rates must return when the rates so established by the board "shall have been abrogated by such board of "supervisors"; so fundamental is this contract *status.*

We do not mean to be understood as claiming that the right to maintain the annual rate established, so far as it relates to mere maintenance and operation, stands on the same footing as being a vested right, as the title to the servitudes. For it is clear that the recurring expenses for current and future maintenance and operation are a common charge to all consumers, the company included; that it may vary; that each consumer has the right to have every other consumer bear his just apportionment thereof, and is under the reciprocal obligation; and that on principle the carrier is not required to expend more in this behalf than it receives. It may be, and probably is true, that this is a matter of such public concern as to be always the subject of the jurisdiction of the board of supervisors when properly called into exercise. What we do assert is, that this is no argument against vested rights in the servitudes.

The statute puts no limitations upon the rights of the carrier and consumer to contract. But when appeal is made to the board there must necessarily be some statutory recognition of the subjects for which rates may be established. We submit that the statute specifically recognizes and provides for fixing rates for

freehold and leasehold servitudes. The first clause of Sec. 5 of the Act of 1885, especially when construed together with Sec. 552 of the Civil Code clearly manifests this. The language is as follows:

"Sec. 5. In the regulation and control of such water rates for "each of such * * * corporations, such board of super- "visors may establish *different* rates at which water may and shall "be *sold*, *rented* or distributed, as the case may be."

We are not here concerned with such occasional, fluctuating and miscellaneous uses of water as are grouped under the head of "distributed"; and dismiss that with the remark that, though the measure of compensation for revenue as well as maintenance were regulated—*e. g.*, by the gallon delivered, still the principle that it is not the water that is sold but the service of the works which is furnished and paid for, remains.

But we are concerned here with those permanent irrigating rights termed easements by Sec. 552; therefor with the terms "sold" and "rented" as used in Sec. 5. We have hereinbefore at length commented on the constitutional reason why these words cannot be taken to mean that the corporation either sells or rents the water itself, since its use is declared to be a "public use". We now point out that neither are these terms used here in the sense of sale or rental of the water as a commodity,

The water used for irrigation is consumed in the use. This is equally true of water whether it is spoken of (mistakenly) as "sold" or "rented". If one gets a year's water supply for his ten acre tract, he uses just as much and consumes it just as absolutely, whether it be said to be sold or rented.

Now, if the water is rented and consumed in the renting, where is the reversion in the water to the lessor—that reversion which is always the incident of a lease?

Again, the statute expressly contemplates different rates at which the water may and shall be "sold" or "rented" as the case may be. But if the same amount of water is used for a given purpose and is absolutely consumed in the use, whether it is said to be sold or rented, why fix different prices on precisely the same thing, simply because in the one case it is said to be sold and in the other rented? This construction of these words is plainly absurd.

The terms "sold" or "rented" refer to the property of the corporation, to-wit, the works; and since it retains the title and contracts for the service of the works, it is the easement in and servitude upon them that is the subject of sale or rental, as the case may be, as indeed is declared by Sec. 552.

So that even after the board acts, we do not get away from contract. For how can there be a sale or rental even after the maximum rates are fixed without a contract; especially when, as decided in the Wheeler case, the parties are at liberty to contract for any rates within the maximum (17 Pac. Rep., 492)?

That all such contracts do not interfere with proper police regulation, see *White* vs. *Reservoir Co.*, 43 Pac. Rep., 1028.

As shown by the cases of Wheeler and Combs, *supra*, the statute always extends to the consumer the right to have a leasehold servitude, if for any reason he does not desire to purchase a servitude in

freehold. In this respect also the rule ten adopted by the corporation and its receiver, above referred to, is sound in principle.

If in acquiring these vested contract rights, which in this case are servitudes, the consumer paid too much, he cannot be heard to complain; the only fact with which the Court is concerned, is that he acquired them. If the corporation sold them too cheaply, or gave them away, that fact is, in the judicial view, also immaterial; the inquiry does not extend beyond the fact that servitudes were granted.

The view of our friends on the opposite side on the vital question in the case, whether the corporation can disregard all vested rights and the existing *status*, are briefly stated in number IV of their points as follows:

"The rates fixed by the company are *changeable* by "it the same as by the board of supervisors. This is "not expressly provided for by the statute, but the "whole tenor of the statute indicates it and the neces- "sity of changing the rates to meet new conditions and "circumstances, is necessary for the protection of both "company and its consumers."

Everything which has thus far been said in this brief centers in a focus upon this single proposition, *whether the company has the legal authority to change its rates as to existing consumers at its own discretion.* We say existing consumers, for the rights of no others are before the Court.

The fifth exception, after alluding to the fact that it appears from the answer that complainant has attempted to jump the rate from $3.50 per acre per annum, as

actually established and collected, to $7.00, avers:

"That the defendants have no standing in this "Court to contest the reasonableness of said rates, but "their remedy, if any they have, is to apply to the "board of supervisors of the county in which their said "land is situated to fix and establish said rates."

Counsel notwithstanding the prayer of their bill, manifest a doubt whether the Court here will exercise a jurisdiction to "inquire into the reasonableness of "rates fixed by the company" (Points No. VI). And at the close of the brief they say, "either the company "or the receiver could bring all the defendants before "the Court, in one suit, *to settle the question of its right* "to establish the rate now in controversy."

If the *reasonableness* of this rate is not a question on which the defendants can be heard, then neither can the complainant. All this appears to be a roundabout way of conceding that the real and ultimate question for decision here, if there is jurisdiction of the subject matter, is whether the complainant had the *naked power* to jump the established rate.

We submit that the fundamental weakness of the complainant's case is that it has no such power. We have already submitted the view that it has no such power upon any view, legal or equitable, aside from the statute.

We now assert that not only is there no affirmative support for this power in the statute; but that it expressly prohibits the exercise of such power both in terms, and by its whole tenor.

Let us suppose that the receiver were to bring a suit at law to recover water rentals unpaid since January 1,

1896, at the rate of $7.00 per acre. If he were to follow the Statute, he must aver that "$7.00 per acre per an-" num is the *actual rate established and collected.*" Under the facts stated in the answer or in the bill, could this be proved? Was $7.00 ever a rate in actual practice? Not at all, it is only proposed.

Has it been a rate collected? Never. The whole burden of the bill of complaint is that the Receiver has not been able to collect the proposed rate, and fears he never will, unless the Court aid him by its judgment and injunction.

Again the statute in terms gives to the consumers, or would-be consumers, provided as many as 25 unite, the privilege in the first instance, exclusive of the carrier, to apply to the board to establish the rate. But of what earthly avail is the exclusive feature of this remedy, if the corporation can get before the board whenever it sees fit, by the simple device of demanding any rate it chooses; and of thereupon inaugurating a water famine, as it has here, for the evident purpose of driving consumers to the board for relief?

The plain meaning and intent of the statute is that when the corporation has drawn in settlers from all quarters of the world, by its promises, representations and contracts as by a net, and has induced them to settle under its system under all the varied circumstances, as in this case, it shall not treat them as captive feudatories under its arbitrary rule as the over-lord. If the statute does not mean this, then there is no such thing as any rate *established* by the corporation; for it is only the sovereign who has power to change a rule that has been established; and even the sovereign in so do-

ing must respect contract rights. If the corporation can at its discretion double the water rates, it is a mockery for the statute to call them "established."

So we submit that the rates fixed by the company are *not* "changeable by it the same as by the Board of Supervisors," as our brethren contend; but that notwithstanding such attempted change, the actual rate hitherto established and collected at $3.50 per acre per annum, must continue to be "deemed and accepted as the legally established rate." And this might well end the discussion.

Miscellaneous Considerations.

But counsel say (Point III) that "the only protec-" tion of the company is its right to fix its own rates"; that is true in the sense, and only in the sense, that when it initiates its scheme it establishes the rate, and has every opportuntity to protect itself in so doing. It was possessed of all the information upon which to base the rate; the people whom it attracted had none, but accepted the company's own terms. Therefore the corporation has had its inning on the rate business. The statute declares in effect that its power in this direction is *functus officio*. The next inning is for the consumers, but under severe restrictions and conditions; and that inning is simply to apply to a *quasi*-judicial body, where the carrier is heard as well as the consumer, and where the hearing is of such a character that the carrier has every advantage; for it is self-evident that a range of permitted award of net revenue anywhere between *six*

and *eighteen* per cent., has possibilities for reducing the tiller of the soil to the condition of the Egyptian fellahin, which it is not agreeable for him to contemplate.

There is another demand, a cause of great vexation to the defendants, which this receiver has coupled with his demand for increased rates and has attempted to make a condition to further water supply after January 1, 1896, to-wit: the demand that they one and all must enter into a contract containing the terms set forth on pp. 33-35 of the answer. The company and the receiver insist on the execution of this contract under the guise of a police regulation. But, as apparent on its face, it is much more; for it is an attempt to compel the defendants to surrender the title to their servitudes and also to give the company or its receiver what amounts to a power of attorney to change the rates to take effect at the close of any year.

The inconsistency of the receiver's course in shutting off the water because defendants would not sign these *contracts*, and his coming before the Court now to be sustained in his acts on the ground that there is no power in carrier or consumer to contract, invites severe comment, but we forbear. But we would that the Court might correct this abuse.

On the question of jurisdiction in respect of the amount involved we merely cite, as in duty bound, the case of *Fishback* vs. *Western Union Tel. Co.*, Supreme Court, Mar. 2, 1896; and we express the hope that the jurisdiction may be maintained; for the community and company as well, need to have the questions raised in this case settled.

Without taking up the exceptions further in detail, we submit that all those touching the merits, should be overruled.

1st. Because the actual irrigation rate established and collected by the company is $3.50 per acre per annum, and that this is the only rate to be deemed and accepted as the legally established rate.

2nd. That neither the company nor its receiver have any power to increase these rates without the consent of the consumers.

3d. That the demand upon the defendants for the execution of the contracts contained in the so-called application for water demanded as a condition to further water supply, is an unlawful attempt to interfere with their constitutional and statutory rights and the rights vested in them under their contracts.

4th. That each of the defendants is the owner of a water right, a constituent part of which is a freehold servitude on the Company's water-system.

5th. That if the case presents any question of the reasonable rate, then that the rate of $3.50 per acre per annum is reasonably and amply sufficient. That substantially the same rate has been maintained by this Court in the National City case under the same state of facts, except that in this case, the defendants show the important additional element in their favor of servitudes on the system *owned* by them.

And, in conclusion, the defendants most respectfully submit that they are not conscious of having invaded any right of the company or its receiver; that they are brought here not upon their own volition; and that therefore they are persuaded that in good conscience

and lifting up clean hands they may make to this Court of Equity their prayer, "Let us have peace."

HAINES & WARD,
Of Counsel for Defendants.

NOTE.—Since the foregoing was written, there has come to our attention the important case of *Merrill* vs. *Southside Irrigation Co.*, decided April 15, 1896, by the Supreme Court of this State. That case holds that Section 552 of the Civil Code is in full force. It therefore affirms that the perpetual easement, and what is the same thing, the right to the continued use of the water, as provided for in that section, may be created under the Constitution.